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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

MICROSOFT CORPORATION, *et al.*,

Petitioners,

—v.—

DONNA VIZCAINO, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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November 24, 1997

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Questions Presented

Respondents, who worked at petitioner Microsoft Corporation ("Microsoft") as "freelancers," each signed agreements providing that they were *not* eligible for employee benefits. The Internal Revenue Service ("IRS") subsequently took the position, however, that certain freelancers were "employees" for federal employment tax purposes, a status that depends on common-law tests of employment without regard to particular contract terms. Microsoft accepted the IRS's position for employment tax purposes only. Respondents then filed this action claiming that, despite the explicit agreements they had entered into, they were entitled to employee benefits.

This petition seeks review as to respondents' claim for one benefit—participation in Microsoft's Employee Stock Purchase Plan ("ESPP"). Although that claim is indisputably governed by Washington contract law, a divided United States Court of Appeals for the Ninth Circuit, sitting *en banc*, held that respondents were entitled to ESPP benefits under principles applicable in cases governed by the Employee Retirement Income Security Act ("ERISA"). As the dissent noted, the Ninth Circuit failed even to acknowledge state decisional law that is directly on point and that rejects the reasoning adopted by the Ninth Circuit.

The questions presented for review, which can be dealt with summarily, are:

> Did the court of appeals contravene this Court's decisions in *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), *Fidelity Union Trust Co.* v. *Field*, 311 U.S. 169 (1940), and *West* v. *AT&T*, 311 U.S. 223 (1940), by following decisional law under inapplicable federal statutes and disregarding state decisional law in determining a question concededly governed by state law?
>
> Should the controlling state-law question be certified to the Supreme Court of Washington for an authoritative answer?

List of Parties and Rule 29.6 Statement

The parties to the proceedings before the United States Court of Appeals for the Ninth Circuit were petitioner Microsoft Corporation and its pension plan and respondents Donna Vizcaino, Jon R. Waite, Mark Stout, Geoffrey Culbert, Lesley Stuart, Thomas Morgan, Elizabeth Spokoiny and Larry Spokoiny.

Petitioner Microsoft Corporation has no parent companies or nonwholly owned subsidiaries.

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IN THE

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OCTOBER TERM, 1997

MICROSOFT CORPORATION, *et al.*,

Petitioners,

v.

DONNA VIZCAINO, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner Microsoft Corporation respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in this case.

Opinions and Order Below

The *en banc* opinion of the court of appeals is reported at 120 F.3d 1006 and is reprinted in the appendix hereto at pages A1 through A36. The original panel opinion is reported at 97 F.3d 1187 and is reprinted in the appendix hereto at pages A37 through A72.

The order of the United States District Court for the Western District of Washington is unreported and is reprinted in the appendix hereto at pages A73 through A77. The report and recommendation of the United States Magistrate Judge is unreported and is reprinted in the appendix hereto at pages A78 through A109.

Jurisdiction

The judgment of the court of appeals was entered on July 24, 1997, and respondents' timely petition for partial rehearing was denied on August 26, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Constitutional and Statutory Provisions Involved

Article III, section 2 of the United States Constitution provides, in pertinent part: "The judicial Power shall extend in all Cases, in Law and Equity, . . . between citizens of different States . . . ."

The Rules of Decision Act, Section 1652 of Title 28, United States Code, provides: "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

Statement of the Case

This case is appropriate for summary disposition by the Court. In a suit seeking participation in a stock purchase plan brought by eight individuals on behalf of themselves and a putative class against a company that had engaged them as independent contractors, the court of appeals (in a divided *en banc* decision) failed to apply governing state contract law, instead choosing to apply principles derived from ERISA that operate without regard to the parties' undisputed mutual intent—in violation of *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), and its progeny. Indeed, the court of appeals majority not only failed to follow settled principles of state contract law, but refused even to acknowledge an intermediate state appellate court decision that—as the dissent explained—is directly on point and "reject[s]" the reasoning adopted by the Ninth Circuit majority. Although this Court may not normally grant petitions for

certiorari to review purported applications of state law, the Court recently stated that it "undoubtedly should do so where the alternative is," as in this case, allowing a "blatant federal-court nullification of state law." *Leavitt* v. *Jane L.*, 116 S. Ct. 2068, 2072 (1996).

Moreover, in disregarding state contract law in favor of inapposite reasoning developed in ERISA cases, the court of appeals' decision threatens to have profound implications far beyond Microsoft and the State of Washington, casting in doubt the enforceability of similar agreements between companies and independent contractors throughout the country. Given the increasingly prevalent use of independent contractors by United States businesses (*see infra* n.10), the court of appeals' decision raises an issue of considerable importance, as the court of appeals itself implicitly acknowledged in deciding to rehear the matter *en banc*. *See* FED. R. APP. P. 35(a) (*en banc* review appropriate "when the proceeding involves a question of exceptional importance").

For these reasons and others discussed below, this is one of those "extraordinary" cases warranting this Court's "summary review." *Leavitt*, 116 S. Ct. at 2072. This Court therefore should exercise its supervisory power and either summarily reverse the judgment below or vacate that judgment and remand with instructions to certify the controlling state-law question to the Supreme Court of Washington for an authoritative answer.

A. Background

Microsoft develops and markets computer software. During the period relevant to this litigation, Microsoft supplemented its employee work force with individuals engaged as independent contractors, generally referred to as "freelancers." Unlike Microsoft's employees, such freelancers were not eligible for employee benefits such as paid vacations and holidays, overtime pay, sick leave, disability benefits and health insurance.

Respondents worked for Microsoft as freelancers between 1987 and 1990, performing a variety of jobs such as production editor, proofreader, formatter, indexer and software tester. (A80) Throughout that period, instead of providing freelancers with employee benefits, Microsoft generally paid them a higher hourly rate than it paid its regular employees. (A27) In addition, freelancers were not paid through Microsoft's payroll department. (A85) Rather, like other independent contractors, they submitted invoices for their services, which documented their hours and the projects on which they worked, and those invoices were paid through Microsoft's accounts payable department. (A85)

Microsoft expressly told all freelancers, including respondents, when they were engaged that they were *not* eligible for any Microsoft employee benefits. (A83-83) Indeed, all of the respondents voluntarily entered into agreements expressly stating that they would be responsible for providing their own benefits. In particular, each respondent signed an Independent Contractor Agreement, which provided:

> CONTRACTOR is an independent contractor for MS [Microsoft]. Nothing in this Agreement shall be construed to create an employer-employee relationship, or guarantee of a future offer of employment. CONTRACTOR further agrees to be responsible for all federal and state taxes, withholding, social security, insurance and other benefits.

(A27) Respondents also signed a one-page companion document entitled Independent Contractor/Freelancer Information, which similarly stated: "[A]s an Independent Contractor to Microsoft, you are self employed and are responsible to pay all your own insurance and benefits." (A83)

Moreover, the evidence in this case established that respondents had no expectation of receiving any Microsoft employee benefits as a part of their compensation for any services they performed for Microsoft. (A82-83) According to

the evidence, to the extent that any of the respondents saw any company materials that mentioned employee benefits, they did not consider themselves eligible for such benefits. (A103) Those company materials uniformly stated that only "regular employees," as that term was defined at Microsoft, were eligible for benefits. (A70) Respondents understood that they were not "regular employees" under that definition and accordingly were *not* eligible for benefits, including stock purchase rights. (A79-80)

In the fall of 1989, the IRS took the position in several letter rulings that certain Microsoft freelancers were "employees" for federal employment tax purposes. The IRS's position was based on a regulation (26 C.F.R. § 31.3401(c)-1(b)) that classifies persons as employees based on fixed common-law factors without regard to any agreements they may have signed with the company for which they were providing services. In view of that determination, the IRS stated that Microsoft would thereafter be required to withhold income taxes and pay the employer's portion of the Federal Insurance Contribution Act tax for those specific freelancers. In response to that ruling, Microsoft hired some freelancers as employees, and others chose to become employees of temporary employment agencies that had contracts with Microsoft and other companies.

After the IRS ruling, respondents requested that Microsoft provide them retroactively with various employee benefits, including the benefit at issue in this petition—*i.e.*, participation in Microsoft's Employee Stock Purchase Plan ("ESPP").[1] Microsoft rejected respondents' request on the ground that, as a matter of Washington contract law, respondents had agreed that they would not receive any employee benefits. Respondents

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[1] Established in 1986, the ESPP permits employees of Microsoft to purchase the company's stock at 85% of the lower of the fair market value on the first or the last day of each six-month offering period through payroll deductions of between two and ten percent.

then brought this class action challenging Microsoft's refusal to provide them with such benefits.[2]

B. The Magistrate Judge's Report and Recommendation

Following cross-motions for summary judgment, the district court referred the matter, including respondents' ESPP claim, to a magistrate judge.

The magistrate judge noted that the ESPP "is *not* one of those types of employee stock option plans governed by ERISA," but rather "is governed by state contract law." (A102 (emphasis in original)) He also emphasized that the "uncontested evidence" is that "Microsoft never expressly offered the ESPP benefit to [respondents]" and that "no [respondent] had any expectation of receiving it as a portion of his/her compensation." (A103) The magistrate judge instead found that respondents "understood that they would *not* receive the benefit." (A103 (emphasis in original)) "[T]o the extent that any of [respondents] knew about the plan or saw any company materials concerning the plan," the magistrate judge added, "they did not consider themselves eligible to participate in the ESPP." (A103)

Despite these findings, which should have been dispositive of respondents' claim under Washington contract law, the magistrate judge went on to hold that respondents were entitled to participate in the ESPP, and therefore recommended that they be granted summary judgment on their ESPP claim. As the sole basis for that ruling, the magistrate judge noted that the ESPP incorporates by reference Section 423 of the Internal Revenue Code, which provides that such plans must extend participation to all "common-law employees" to qualify for favorable tax treatment. *See* 26 U.S.C. § 423(b)(4). Ignoring the requisites of

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[2] The district court had jurisdiction pursuant to 29 U.S.C. § 1132(e)(1) and 28 U.S.C. §§ 1331 and 1367(a).

contract formation—*i.e.*, offer, acceptance and consideration—the magistrate judge stated:

> Since Microsoft expressly created an ESPP intended to comply with § 423, and in fact expressly embraced the coverage extended by § 423, and since § 423 permits a company to exclude common law employees only by reason of factors not applicable to [respondents], [respondents] were entitled to participate in the ESPP.

(A107)

C. The District Court's Order

The district court rejected the magistrate judge's recommendation and instead granted Microsoft summary judgment on respondents' ESPP claim. The district court explained:

> First, the contract between Microsoft and [respondents] specifically stated that no benefits were provided by Microsoft. Second, because the terms of the plan were not communicated to [respondents], they could not have become part of the contract between them and Microsoft. Thus, [respondents] had no expectation of receiving any benefits, including ESPP benefits. Finally, as Microsoft asserts, I.R.C. § 423 does not create a right of action by [respondents] against Microsoft. Section 423 does not require Microsoft to open its plan to all employees; rather, Section 423 conditions beneficial tax treatment of employees who are participants upon the plan allowing participation of all employees. Accordingly, Section 423 may not be used to create a right of action by [respondents].

(A 76-77 (citations omitted))

Respondents appealed the dismissal of, *inter alia*, their claim for participation in the ESPP.

D. The Ninth Circuit's Panel Decision

Over a vigorous dissent by Judge Trott, a panel of the court of appeals reversed the district court's grant of summary judgment on respondents' ESPP claim. *Vizcaino* v. *Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996).[3] At the outset of its opinion, the majority acknowledged that the ESPP is "not subject to ERISA" but rather is "governed by Washington state law." 97 F.3d at 1196 (A54). Nevertheless, the majority failed to examine whether Microsoft and respondents had entered into a contract entitling respondents to participate in the ESPP.

The majority instead analyzed the ESPP exactly as if it were an ERISA plan. Under ERISA—unlike state contract law—employees generally may enforce the terms of certain employee benefit plans without regard to whether they have a contractual right to do so. *See* 29 U.S.C. § 1132(a). Consistent with treating the ESPP as if it were a plan governed by ERISA, the majority stated that this case is "about the construction of the terms of a plan." 97 F.3d at 1197 (A56) The majority then went on to hold that respondents "are covered by [the] specific provisions" of the ESPP, without ever examining the terms of respondents' actual contracts with Microsoft:

> [W]e find that the ESPP, through its incorporation of § 423, expressly extends eligibility for participation to [respondents] and affords them the same options to acquire stock in the corporation as all other employees.

97 F.3d at 1197 (A55-56). In so doing, the majority expressly acknowledged that its approach is "similar" to that which applies

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[3] In the very first sentence of its opinion, written by Judge Reinhardt, the majority revealed its philosophical bent on the question before it, stating, without reference to or support in the record: "Large corporations have increasingly adopted the practice of hiring temporary employees or independent contractors as a means of avoiding payment of employee benefits, and thereby increasing their profits." 97 F.3d at 1189 (A38).

"to plans that require compliance with the provisions of ERISA." 97 F.3d at 1197 n.12 (A56-57) (citing two ERISA cases).

In his dissent, Judge Trott criticized the majority for ignoring fundamental requirements of contract law:

> [T]he majority engages in analytical gymnastics to find a contractual right where none exists. No one disputes that the offer made by Microsoft and accepted by [respondents] explicitly excluded the ESPP benefits now sought . . . . Microsoft never offered the benefits to [respondents], either bilaterally or unilaterally, [respondents] never accepted them, and [respondents] never relied on them in any way whatsoever as part of their compensation package.

97 F.3d at 1203 (A70). As Judge Trott put it, "without offer, without acceptance, without consideration, and without a meeting of the minds, the majority creates by operation of law a contractual right on behalf of [respondents] that they never even contemplated until this lawsuit began." 97 F.3d at 1203 (A70).

Indeed, Judge Trott expressed dismay at the majority's total disregard of Washington contract law. *See* 97 F.3d at 1203 (A71). "Because we are bound to apply state law to this dispute," Judge Trott stated, "we have no authority to impair the obligation of these contracts." 97 F.3d at 1204 (A71-72) (citing U.S. CONST. art. I, § 10, cl. 1). "To do so," noted Judge Trott, "is tantamount to depriving Microsoft of property without due process of law." 97 F.3d at 1204 (A72).

E. The Ninth Circuit's *En Banc* Decision

The court of appeals thereafter agreed to rehear the appeal *en banc*.[4] Once again over a vigorous dissent—this time by Judge O'Scannlain (joined by Judge Hall and Judge T.G. Nelson)—the *en banc* majority held that respondents were entitled to participate in the ESPP. *Vizcaino* v. *Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997).

The *en banc* majority began by emphasizing that the IRS had already determined (albeit for employment tax purposes and *only* for such purposes) that respondents "were employees of Microsoft, and not independent contractors." 120 F.3d at 1009 (A6). It then trivialized respondents' written contracts with Microsoft, which expressly provide that respondents are not eligible for employee benefits, as "simply a helpful disclosure" with no independent legal significance. 120 F.3d at 1011 (A9). Relying on an ERISA case from the Eleventh Circuit, the *en banc* majority concluded that respondents "are entitled to the benefits of all other employees, or, at least, they are not excluded simply because of the contractual terms." 120 F.3d at 1012 (A11-12) (citing *Daughtrey* v. *Honeywell, Inc.*, 3 F.3d 1488 (11th Cir. 1993)).

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[4] In its petition for rehearing, Microsoft noted that if the court concluded that Washington law was unclear, "the question could have been certified to the State Supreme Court for resolution." After the court of appeals had already decided to rehear the matter *en banc*, and a mere 13 days before oral argument, respondents filed a motion to certify state law issues to the Washington Supreme Court. In their motion papers, respondents noted that the court of appeals' decision to rehear the matter demonstrated that the case involves "important issues" and that "there is no decision on point from the Washington Supreme Court." Microsoft opposed respondents' motion to certify because, in its view, the "law in Washington is clear and well settled." Microsoft reiterated, however, that "if the Court should determine that Washington law is unclear on dispositive issues, it should certify those questions to the Washington Supreme Court."

"Having thus burned off the brumes which threatened to obscure [its] view"—*i.e.*, respondents' written contracts with Microsoft—the *en banc* majority turned to the ESPP itself. 120 F.3d at 1013 (A13). Like the original panel majority, the *en banc* majority treated the ESPP as if it were an ERISA plan, and thus accorded no significance to the fact that Microsoft and respondents had not formed a contract for participation in the ESPP. The *en banc* majority concluded:

> The ESPP was created and offered to all employees, [respondents] knew of it, even if they were not aware of its precise terms, and their labor gave them a right to participate in it.

120 F.3d at 1014 (A17). The *en banc* majority then simply asserted, without explanation and ignoring a decision of the Washington Court of Appeals holding to the contrary (*see infra* 12-13, 14-15), that it was "confident" that the Washington Supreme Court "would apply the same reasoning to this employee benefit." 120 F.3d at 1014 (A17).

Applying the correct analytical framework, Judge O'Scannlain, joined by Judges Hall and T.G. Nelson, concluded in his dissent that respondents had not entered into a valid contract for participation in the ESPP under Washington law for three reasons. *First*, to the extent that Microsoft offered the opportunity to participate in the ESPP to employees generally, Judge O'Scannlain found that Microsoft revoked that offer vis-à-vis respondents by giving them specific notice that they would not receive such employee benefits. As Judge O'Scannlain put it, "Microsoft's board offered the ESPP to employees generally, and then Microsoft told [respondents]: 'We aren't offering the ESPP to you; ESPP benefits are not included in your contract.'" 120 F.3d at 1020 (A29). *Second*, Judge O'Scannlain found that "there was no mutual assent (or 'meeting of the minds')" because "Microsoft did not think it was offering ESPP benefits to [respondents] and [respondents] did not think they were accepting an offer of ESPP benefits." 120 F.3d at 1020 (A30).

Third, Judge O'Scannlain found a lack of consideration because "[t]here was no detrimental reliance on the ESPP by [respondents]." 120 F.3d at 1020 (A30). "If anything," Judge O'Scannlain noted, respondents "received consideration (a higher hourly rate) for their agreement that they would not get ESPP benefits." 120 F.3d at 1020 (A30). Thus, to hold, as the *en banc* majority did, that respondents are also entitled to receive ESPP benefits—something they never expected to receive—is to give them an undeserved financial windfall.

Judge O'Scannlain also took the *en banc* majority to task for dismissing the relevant statements in respondents' written contracts with Microsoft as "simply a helpful disclosure":

> When one sets the ESPP side-by-side with the agreements signed by [respondents], one realizes that no brumes obscure the court's view . . . . Microsoft drafted the ESPP and the agreements using the same terminology ("employee") to ensure there could be no mistaking that ESPP benefits were not part of the bargain . . . . By "burning off" this inconvenient contract language, the court may as well have set fire to the contracts themselves.

120 F.3d at 1020 (A30-31).

Finally, Judge O'Scannlain pointed out that the *en banc* majority (while professing "confidence" that the Washington Supreme Court would reach the same result) ignored the rule of law announced by the Court of Appeals of Washington in *Daniel* v. *Pacific Northwest Bell Telephone Co.*, 580 P.2d 652 (Wash. Ct. App.), *review denied*, 90 Wash. 2d 1025 (1978). 120 F.3d at 1020-21 (A31). As Judge O'Scannlain explained, the plaintiff in *Daniel* signed a written agreement with the defendant telephone company stating that he was an independent contractor, even though—had his position been determined by common-law standards—he may have been an employee. 120 F.3d at 1021 (A31). In such circumstances, Judge O'Scannlain noted, the Washington Court of Appeals held that "the charac-

terization of [plaintiff's] employment as that of an independent contractor is binding between [plaintiff] and the telephone company." 580 P.2d at 654. Following state law, Judge O'Scannlain thus reasoned that "[r]egardless of whether Microsoft and [respondents] were mistaken about [respondents'] employment status" at common law for employment tax purposes, their explicit agreement that respondents were independent contractors and not eligible for benefits "stands on its own and ought to be enforced according to its terms." 120 F.3d at 1020-21 (A32).

Reasons for Granting the Writ

I.

The Ninth Circuit Refused to Follow the Governing Rule of Law Announced by the Court of Appeals of Washington.

The Ninth Circuit *en banc* majority acknowledged that "the law of the State of Washington . . . applies here," 120 F.3d at 1014 (A16), yet failed to follow the controlling rule of law announced by the Court of Appeals of Washington, an intermediate Washington appellate court, in *Daniel* v. *Pacific Northwest Telephone Co.*, 580 P.2d 652 (Wash. Ct. App.), *review denied*, 90 Wash. 2d 1025 (Wash. 1978). In fact, the *en banc* majority did not even acknowledge that decision, let alone attempt to distinguish it, even though, as Judge O'Scannlain pointed out in his dissent, it is directly on point.

In ignoring the Washington Court of Appeals' decision in *Daniel*—and instead applying inapposite reasoning developed in ERISA cases—the *en banc* majority failed to apply state law as required by this Court's decision in *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938). In *Guaranty Trust Co.* v. *York*, 326 U.S. 99 (1945), the Court explained the rule of *Erie* as follows:

> [I]n all cases where a federal court is exercising jurisdiction solely because of diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same . . . as it would be if tried in a State court.

Id. at 109. That the *en banc* majority attempted to cloak its disregard of the rule of *Erie* by citing inapposite state court decisions does not make this Court's review any less necessary. As this Court recently noted, although it does not "normally grant petitions for certiorari solely to review what purports to be an application of state laws," this Court "undoubtedly should do so where the alternative is allowing blatant federal-court nullification of state law." *Leavitt* v. *Jane L.*, 116 S. Ct. 2068, 2072 (1996) (summarily reversing court of appeals decision misapplying Utah law). The court of appeals' decision in this case is just such a "blatant federal-court nullification of state law," making this one of those "extraordinary" cases warranting this Court's "summary review." *Id.*

As Judge O'Scannlain recognized in dissent, "Washington courts have already rejected [the Ninth Circuit *en banc* majority's] reasoning." 120 F.3d at 1020 (A31). In *Daniel*, the plaintiff sued the company for which he had worked, claiming that he was entitled to employee benefits despite the fact that, like respondents, he had signed written agreements with the company expressly providing that he was an independent contractor, not an employee. As in this case, the "basic question presented" in *Daniel* was "whether the parties' characterization of [plaintiff's] relationship with [the company] contained in their written employment agreement is binding as between them" for purposes of determining plaintiff's entitlement to certain benefits. 580 P.2d at 653. In seeking such benefits, plaintiff argued that "the agreements signed by the parties [did] not foreclose him from showing that in actuality he was an employee, and not an independent contractor." *Id.* "The trial court held that the agreement unambiguously established

[plaintiff's] status to be that of an independent contractor," and that, "[a]s a consequence, [plaintiff] was not entitled to the benefits of an employee." *Id.*

Noting that "[i]t is well settled that one is bound by the contract which he voluntarily and knowingly signs," *id.* at 654, the Washington Court of Appeals rejected plaintiff's attempt to show that he was actually an employee. The court stated that "[t]he provision defining [plaintiff's] status is clear and unambiguous" and "was contained in every agreement signed by the parties." The court also determined that plaintiff "was fully aware that the contract did not intend to cover the benefits that he now seeks." *Id.* "In these circumstances," the court held, "the characterization of [plaintiff's] employment as that of an independent contractor is binding as between [plaintiff] and the telephone company." *Id.*

By the same reasoning, the agreements that respondents voluntarily signed—which provided that they were independent contractors for, not employees of, Microsoft and that they would *not* receive Microsoft employee benefits—should be binding as a matter of contract between them and Microsoft, irrespective of respondents' status for federal tax purposes. In short, the Washington Court of Appeals' decision in *Daniel* teaches that, under Washington contract law, respondents' voluntary agreement to forgo benefits bars their claim for such benefits, whether or not they were employees under common-law standards.

There is, to be sure, no decision directly on point from the Supreme Court of Washington, as respondents themselves have acknowledged. (*See supra* n.4.) This Court has recognized, however, that "[a] state is not without law save as its highest court has declared it." *West* v. *AT&T*, 311 U.S. 223, 236 (1940). Instead, "whether the question is one of statute or common law," the decision of an intermediate appellate court like the Washington Court of Appeals is "entitled to like respect as announcing the law of the State." *Fidelity Union Trust Co.* v.

Field, 311 U.S. 169, 178, 79 (1940). As this Court explained, "[a]n intermediate state court in declaring and applying the state law is acting as an organ of the State and its determination, in the absence of more convincing evidence of what the state law is, should be followed by a federal court in deciding a state question." *Id.* at 177-78.[5]

A federal court is thus not free to reject, as the court of appeals did here, a rule of law announced by an intermediate state court "merely because it has not received the sanction of the highest state court, even though [the federal court] thinks the rule is unsound in principle or that another is preferable." *West*, 311 U.S. at 236-37; *accord Fidelity Union*, 311 U.S. at 179. A federal court is likewise not free to reject, as the court of appeals also did here, a decision of an intermediate state court that is directly on point in favor of a decision or decisions of the highest state court that only tangentially relate to the question presented. *See West*, 311 U.S. at 235.[6] This rule is "of great importance to

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[5] *Accord, e.g.*, *King* v. *Order of United Commercial Travelers of Am.*, 333 U.S. 153, 158 (1948) ("federal courts are bound by decisions of a state's intermediate appellate courts unless there is persuasive evidence that the highest state court would rule otherwise"); *Sooner* v. *New York Life Ins. Co.*, 311 U.S. 464, 467 (1940) (federal courts "must follow the decisions of intermediate state courts in the absence of convincing evidence that the highest court of the state would decide differently"); *Six Companies of Cal.* v. *Joint Highway District No. 13 of Cal.*, 311 U.S. 180, 188 (1940) (same).

[6] The Washington Supreme Court decisions cited by the Ninth Circuit *en banc* majority (120 F.3d at 1014 (A16-17)), which dealt with pension plans—not enhancements to current income, such as stock purchase plans—are not on point. For example, *Dorward* v. *ILWU-PMA Pension Plan*, 452 P.2d 258, 261 (Wash. 1969)—the Washington Supreme Court decision on which the *en banc* majority principally relies—holds only that all employees covered by a collective bargaining agreement are entitled to participate in a pension plan established by that agreement, hardly an analogous situation. More fundamentally, none of the cases

(continued...)

the proper administration of justice in the federal courts" because, as this Court explained, it is unacceptable that "there should be one rule of state law for litigants in the state courts and another rule for litigants who bring the same question before the federal courts . . . ." *Fidelity Union*, 311 U.S. at 179-80.[7]

In disregarding controlling state decisional law and instead applying the ESPP as if it were governed by federal ERISA law, the court of appeals contravened its *Erie* duty and, to reach its startling result, all but re-wrote the parties' contracts. As Judge Trott noted in his dissent from the panel decision, the court of appeals' "radical" decision "creates by operation of law a contractual right on behalf of [respondents] that they never even contemplated until this lawsuit began." 97 F.3d at 1203 (A70). The "proper administration of justice" requires that federal courts faithfully apply state law in cases such as this. Moreover,

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[6](...continued)
cited by the *en banc* majority involved a situation where, as in this case, the company entered into specific individual agreements with plaintiffs expressly providing that plaintiffs would *not* receive the benefit in question and later issued publications that expressly notified plaintiffs that they were not entitled to the benefit. *See Bowles* v. *Washington Dep't of Retirement Sys.*, 847 P.2d 440 (Wash. 1993); *Culinary Workers & Bartenders Union No. 596 Health & Welfare Trust* v. *Gateway Cafe, Inc.*, 588 P.2d 1334 (Wash. 1979); *Jacoby* v. *Grays Harbor Chair & Mfg. Co.*, 468 P.2d 666 (1970). In short, as respondents have already conceded (*see supra* n.4), "there is no decision on point from the Washington Supreme Court."

[7] Other courts of appeals continue to recognize that they are bound under *Erie* to adhere to the decisions of a state's intermediate appellate courts absent convincing evidence that the state's highest court would decide the issue otherwise. *See, e.g., Kurczi* v. *Eli Lilly & Co.*, 113 F.3d 1426, 1429 (6th Cir. 1997); *Fioretti* v. *Massachusetts General Life Ins. Co.*, 53 F.3d 1228, 1236 n.28 (11th Cir. 1995), *cert. denied*, 116 S. Ct. 708 (1996); *Northern Ins. Co. of New York* v. *Aardvark Assocs., Inc.*, 942 F.2d 189, 193 (3d Cir. 1991); *Exxon Co., U.S.A., a Div. of Exxon Corp.* v. *Banque De Paris Et Des Pays-Bas*, 889 F.2d 674, 675 (5th Cir.), *cert. denied*, 496 U.S. 943 (1990).

the court of appeals' decision casts doubt on the enforceability of similar agreements between companies and independent contractors throughout the country. As a result, the decision below "call[s] for an exercise of this Court's supervisory power." Rule 10(a).

Accordingly, pursuant to Rule 16.1, this Court should grant certiorari and summarily reverse the judgment of the court of appeals for failure to follow the rule of law announced by the Washington Court of Appeals in *Daniel*, as the alternative is to allow a "blatant federal-court nullification of state law." *Leavitt*, 116 S. Ct. at 2072.

II.

At a Minimum, the Question Should Be Certified to the Supreme Court of Washington.

Like many States, Washington has adopted a certification procedure pursuant to which any federal court, including this Court, can submit a question of Washington law to the Supreme Court of Washington for an authoritative answer. *See* WASH. REV. CODE ANN. § 2.60.010(1) & (2).[8] The Washington certification statute provides:

> When in the opinion of any federal court before whom a proceeding is pending, it is necessary to ascertain the local law of this state in order to dispose of such proceeding and the local law has not been clearly determined, such federal court may certify to the supreme court for answer the question of local law involved and the supreme court shall render its opinion in answer thereto.

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[8] *See* 17A CHARLES A. WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4248 (2d ed. 1988) (citing other States' certification procedures).

Id. § 2.60.020; *accord* WASH. R. APP. P. 16.16(a) ("The Supreme Court may entertain a petition to determine a question of law certified to it . . . if the question of state law is one which has not been clearly determined and does not involve a question determined by reference to the United States Constitution."). This procedure "may be invoked by a federal court upon its own motion or upon the motion of any interested party in the litigation involved if the federal court grants such motion." WASH. REV. CODE ANN. § 2.60.030(1).

In *Lehman Brothers* v. *Schein*, 416 U.S. 386, 391-92 (1974), this Court vacated a judgment of a court of appeals and remanded the case with instructions to "reconsider whether the controlling issue of Florida law should be certified to the Florida Supreme Court." In so ruling, the Court emphasized that certification "helps build a cooperative judicial federalism," explaining that when federal judges attempt to predict uncertain state law, they act "as 'outsiders' lacking the common exposure to local law which comes from sitting in the jurisdiction." *Id.* at 391.[9]

If the controlling question of Washington contract law in this case was not clearly determined by the Washington Court of Appeals in *Daniel*, then it should be certified to the Supreme Court of Washington for an authoritative answer. The controlling question of law here is obviously important, as respondents acknowledged in their motion to certify the question pursuant to Rule 16.16(a) of the Washington Rules of Appellate Procedure. (*See supra* n.4.) Not only did the court of appeals decide to rehear this matter *en banc*, *see* FED. R. APP. P. 35(a), but nine

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[9] This Court has similarly endorsed the use of certification procedures to obtain authoritative answers to unsettled questions of state law from a state's highest court in a number of other cases. *See, e.g., Arizonans for Official English* v. *Arizona*, 117 S. Ct. 1055, 1072-75 (1997); *Virginia* v. *American Booksellers Ass'n*, 484 U.S. 383, 395-98 (1988); *Elkins* v. *Moreno*, 435 U.S. 647, 662, 668-69 (1978); *Bellotti* v. *Baird*, 428 U.S. 132, 150-52 (1976).

different *amici curiae* filed briefs that stress the importance of the question presented.[10] Moreover, given the increasing use of independent contractors by United States companies, particularly in the high tech sector (*see supra* n.10), the question presented here is likely to recur frequently, making certification all the more appropriate. *See* WRIGHT, MILLER & COOPER, *supra* § 4248, at 173-74 ("Questions that recur frequently are more likely candidates for certification than those that are uncommon."). Finally, there are few, if any, disputed factual issues in this case that would make "it difficult or impossible to agree on what the legal questions are"—yet another factor favoring certification. *Id.* § 4248, at 174.

Microsoft opposed respondents' motion in the court of appeals to certify state-law issues to the Washington Supreme Court solely because Microsoft believed that the relevant issue had already been clearly determined. Although Microsoft continues to believe that the issue here involves a straight-forward application of basic contract law principles—an issue that was definitively resolved by the Washington Court of Appeals in

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[10] Further attesting to the importance of the issue, the day after the Ninth Circuit handed down its *en banc* decision, the *Wall Street Journal* reported that the ruling "could have significant implications for employers across the country, who have increasingly turned to contract employees to better manage global employment demands and to cut costs." Charles McCoy & David Bank, *Microsoft Loses Appeal in Worker-Benefits Case*, WALL ST. J., July 25, 1997, at A3. The *Wall Street Journal* predicted that the implications would be greatest for high-tech companies, which "use squadrons of contract workers, many of them white-collar code writers and software designers." *Id.* An earlier *Wall Street Journal* article, written after the original Ninth Circuit panel decision, similarly stated that the decision "has cast a cloud over how U.S. industry uses one of its most crucial competitive weapons: the temporary worker." *Temps Win Full-Time Benefits at Microsoft in Business Setback*, WALL ST. J., Oct. 14, 1996, at B7. That earlier article also cited a study by a labor-advocacy group, which found that "a quarter or more of the work force in tech wellspring Silicon Valley comprises temporary workers or other so-called contingent workers." *Id.*

Daniel—should there be any doubt of the correctness of that position, *Daniel* and the spirited dissents below show beyond question that the law of Washington "has not been clearly determined" to be what was declared by the court of appeals majority. WASH. REV. CODE ANN. § 2.60.020.

Thus, if this Court does not summarily reverse the judgment below, the Court should, as an exercise of its supervisory power, grant certiorari, vacate the judgment and remand the case with instructions to certify the following question to the Supreme Court of Washington pursuant to Rule 16.16(a) of the Washington Rules of Appellate Procedure:

> Are respondents and Microsoft bound among themselves by the terms of their written contracts providing that respondents were independent contractors of Microsoft and that they were not entitled to employee benefits, regardless of whether respondents had the status of employees of Microsoft under common-law standards?

Conclusion

For the foregoing reasons, the Court should grant certiorari and summarily reverse the judgment of the court of appeals for refusing to apply the rule of law announced by the Court of Appeals of Washington in *Daniel* v. *Pacific Northwest Telephone Co.*, 580 P.2d 652 (Wash. Ct. App.), *review denied*, 90 Wash. 2d 1025 (Wash. 1978). In the alternative, the Court should grant certiorari, vacate the judgment of the court of appeals and remand the case with instructions to certify the

dispositive question of Washington law to the Supreme Court of Washington.

Respectfully submitted,

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November 24, 1997

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DONNA VIZCAINO; JON R. WAITE; MARK STOUT; GEOFFREY CULBERT; LESLEY STUART; THOMAS MORGAN; ELIZABETH SPOKOINY; LARRY SPOKOINY,	)	No. 94-35770
Plaintiffs-Appellants,	)	D.C. No. CV-93-00178-CRD
v.	)	OPINION
MICROSOFT CORPORATION, and its pension and welfare benefit plans, et al.,	)	
Defendants-Appellees.	)	

Appeal from the United States District Court
for the Western District of Washington
Carolyn R. Dimmick, District Judge, Presiding

Argued and Submitted
March 27, 1997

Decided July 24, 1997

Before: HUG, Chief Judge, and Browning, Fletcher, Pregerson, Hall, O'Scannlain, Fernandez, T.G. Nelson, Hawkins, Tashima, and Thomas, Circuit Judges

Opinion by Judge Fernandez; Partial Concurrence and Partial Dissent by Judge Fletcher; Partial Concurrence and Partial Dissent by Judge O'Scannlain

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Linda J. Dunn, Office of the Attorney General, Seattle, WA, for amicus Washington State Department of Labor and Industries.

OPINION

FERNANDEZ, Circuit Judge.

Donna Vizcaino, Jon R. Waite, Mark Stout, Geoffrey Culbert, Lesley Stuart, Thomas Morgan, Elizabeth Spokoiny, and Larry Spokoiny brought this action on behalf of themselves and a court-certified class (all are hereafter collectively referred to as "the Workers"). They sued Microsoft Corporation and its various pension and welfare plans, including its Savings Plus Plan (SPP), and sought a determination that they were entitled to participate in the plan benefits because those benefits were available to Microsoft's common law employees. The district

court granted summary judgment against the Workers, and they appealed the determinations that they were not entitled to participate in the SPP or in the Employee Stock Purchase Plan (ESPP). We reversed the district court because we decided that the Workers were common law employees who were not properly excluded from participation in those plans. *See Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (9th Cir.1996) (*Vizcaino I*). However, we then decided to rehear the matter en banc, and we now agree with much of the panel's conclusion and reverse the district court.

BACKGROUND

At various times before 1990, Microsoft hired the Workers to perform services for it. They did perform those services over a continuous period, often exceeding two years. They were hired to work on specific projects and performed a number of different functions, such as production editing, proofreading, formatting, indexing, and testing. "Microsoft fully integrated [the Workers] into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required that they work on site, they received admittance card keys, office equipment and supplies from the company." *Id.* at 1190. However, they were not paid for their services through the payroll department, but rather submitted invoices to and were paid through the accounts payable department.

Microsoft did not withhold income or Federal Insurance Contribution Act taxes from the Workers' wages, and did not pay the employer's share of the FICA taxes. Moreover, Microsoft did not allow the Workers to participate in the SPP or the ESPP. The Workers did not complain about those arrangements at that time.

However, in 1989 and 1990 the Internal Revenue Service examined Microsoft's records and decided that it should have been withholding and paying over taxes because, as a matter of law, the Workers were employees rather than independent contractors. It made that determination by applying common law principles. Microsoft agreed with the IRS and made the necessary corrections for the past by issuing W-2 forms to the Workers and by paying the employer's share of FICA taxes to the government.

Microsoft also realized that, because the Workers were employees, at least for tax purposes, it had to change its system. It made no sense to have employees paid through the accounts payable department, so those who remained in essentially the same relationship as before were tendered offers to become acknowledge employees. Others had to discontinue working for Microsoft, but did have the opportunity to go to work for a temporary employment agency, which could then supply temporary Workers to Microsoft on an as-needed basis. Some took advantage of that opportunity, some—like Vizcaino—did not.

The Workers then asserted that they were employees of Microsoft and should have had the opportunity of participating in the SPP and the ESPP because those plans were available to all employees who met certain other participation qualifications, which are not relevant to the issues before us. Microsoft disagreed, and the Workers asked the SPP plan administrator to exercise his authority to declare that they were eligible for the benefits. A panel was convened; it ruled that the Workers were not entitled to any benefits from ERISA plans[1] —for example, the SPP—or, for that matter, from non-ERISA plans—for example, the ESPP. That, the administrative panel seemed to

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[1] *See* Employee Retirement Income Security Act of 1974, Pub.L. No. 93-406, 88 Stat. 829 (1974).

say, was because the Workers had agreed that they were independent contractors and because they had waived the right to participate in benefit plans. This action followed.

JURISDICTION AND STANDARD OF REVIEW

The district court had jurisdiction pursuant to 29 U.S.C. § 1132(e)(1) and 28 U.S.C. §§ 1331 and 1367(a). We have jurisdiction pursuant to 28 U.S.C. § 1291.

We review the district court's grant of summary judgment de novo. *See Bagdadi v. Nazar*, 84 F.3d 1194, 1197 (9th Cir.1996). However, when reviewing the decision of a plan administrator who has discretion, "the exercise of that discretion is reviewed under the arbitrary or capricious standard, or for abuse of discretion, which comes to the same thing." *Snow v. Standard Ins. Co.*, 87 F.3d 327, 330 (9th Cir.1996); *see also Saffle v. Sierra Pac. Power Co. Bargaining Unit Long Term Disability Income Plan*, 85 F.3d 455, 458 (9th Cir.1996).

DISCUSSION

Although the Workers challenge both their exclusion from the SPP and their exclusion from the ESPP, the two plans are subject to rather different legal regimes. The former is a 26 U.S.C. § 401(k) plan, which is governed by ERISA; the latter is a 26 U.S.C. § 423 plan, which is not governed by ERISA. It, instead, is governed, at least in large part, by principles arising out of the law of the State of Washington. Nevertheless, certain issues, perhaps the most critical ones, cut across both regimes, and we will address them first.

I. GENERAL CONSIDERATIONS.

A. The Workers' Status.

It is important to recognize that there is no longer any question that the Workers were employees of Microsoft, and not independent contractors. The IRS clearly determined that they were. In theory one could argue that what the IRS said was fine for withholding and FICA purposes, but that is as far as it goes.

However, the IRS made its determination based upon the list of factors which is generally used to decide whether a person is an independent contractor or an employee. *See* 26 C.F.R. § 31.340(c)-1(b). The same essential definition is used for § 401(k) plans, *see* 26 C.F.R. § 1.4010(b)-9, and for § 423 plans, *see* 26 C.F.R. §§ 1.423-2(e)(2), 1.421-7(h). That there should be a congruence of approaches is not surprising. As the Supreme Court has pointed out, when Congress uses the work "employee," courts " 'must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning' " of that word. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322, 112 S.Ct. 1344, 1348, 117 L.Ed.2d 581 (1992). The Court then went on to scrutinize the various typical factors that go into a determination of whether a person is an employee. *See id.* at 323-24, 112 S.Ct. at 1348. Those were the usual common law factors. But, again, we recognize that one could still question the IRS's application of those factors in a particular case.

That question is obviated here for, perhaps more to the purpose, both Microsoft and the SPP have conceded for purposes of this appeal that the Workers were common law employees. In fact, they have asserted that the Workers' status is a "nonissue" because they concede that the Workers were common law employees. That is to say, they were employees of Microsoft.

B. The Employment Agreements.

The concession that the Workers were employees would, at first blush, appear to dispose of this case. It means that for legal purposes they, along with the other employees of Microsoft, were subject to Microsoft's control as to both "the manner and means" of accomplishing their job, that they worked for a substantial period, that they were furnished a workplace and equipment, that they were subject to discharge, and the like. *See id.*; *see also* 26 C.F.R. § 31.3401(c)-1(b). If that were all, this would be an exceedingly easy case. Of course, it is not all.

Microsoft also entered into special agreements with the Workers, and it is those which complicate matters to some extent. Each of the Workers and Microsoft signed agreements which stated, among other things not relevant here, that the worker was "an Independent Contractor for [Microsoft]," and nothing in the agreement should be construed as creating an "employer-employee relationship." As a result, the worker agreed "to be responsible for all of [his] federal and state taxes, withholding, social security, insurance, and other benefits." At the same time, Microsoft had the Workers sign an information form, which explained: "[A]s an Independent Contractor to Microsoft, you are self employed and are responsible to pay all your own insurance and benefits... Microsoft ... will not subject your payments to any withholding.... You are not either an employee of Microsoft, or a temporary employee of Microsoft." We now know beyond peradventure that most of this was not, in fact, true because the Workers actually were employees rather than independent contractors. What are we to make of that?

We now know that as a matter of law Microsoft hired the Workers to perform their services as employees and that the Workers performed those services. Yet we are also obligated to construe the agreements. *See Republic of Nicaragua v. Standard Frutie Co.*, 937 F.2d 469, 474 (9th Cir.1991); *Swanson v.*

Liquid Air Corp., 118 Wash.2d 512, 521, 826 P.2d 664, 669 (1992). In doing so, we could take either a negative or a positive view of Microsoft's intent and motives. We could decide that Microsoft knew that the Workers were employees, but chose to paste the independent contractor label upon them after making a rather amazing series of decisions to violate the law. Or we could decide that Microsoft mistakenly thought that the Workers were independent contractors and that all else simply seemed to flow from that status.

Were we to take the former approach, we would have to determine that Microsoft, with the knowledge that the Workers were simply a group of employees, decided to engage in the following maneuvers:

(1) Despite the requirements of federal law that amounts be withheld from employee wages, Microsoft decided it would not withhold. *See* 26 U.S.C.§§ 3102, 3401-3406.

(2) Despite the fact that the SPP states that "employee" means "any common law employee ... who is on the United States payroll of the employer," Microsoft decided to manipulate the availability of that benefit by routing the wages of these employees through the accounts payable department, so that it could argue that they were not on the United States payroll. Beyond that, it also determined that it would tell the IRS in its "Application for Determination for Defined Contribution Plan," that Microsoft did, indeed, basically include all employees, a category that it knew included the Workers, even thought it had contrived to exclude them. Beyond even that, Microsoft excluded these employees when it filed its tax returns for the SPP, even though it knew better.

(3) Despite the fact that the ESPP must, essentially, be made available to all employees, Microsoft excluded these employees and thereby intentionally risked the possibility that

the plan would not qualify for favorable tax treatment. It did that, even though the plan itself stated that it covered all regular employees and that it was to be construed to comply with 26 U.S.C. § 423, a law which basically requires that all employees be covered. The officers of Microsoft also decided to eliminate one group of common law employees from the benefits, even though the board of directors and the shareholders had already made the benefits of the ESPP available to those employees. In doing that, the officers intentionally violated the corporate law of Delaware, to which Microsoft was subject, because the terms of coverage of stock option plans are not in the hands of corporate officers; they are in the hands of the board itself. *See Del. Code Ann. tit.* 8 § 157; *see also Michelson v. Duncan*, 386 A.2d 1144, 1150-51 (Del.Ch.1978), *aff'd in part and rev'd in part on other grounds*, 407 A.2d 211 (Del.1979).

On the other hand, in construing the agreements we can view the label as a simple mistake. That is, Microsoft honestly thought that the Workers were independent contractors and took its various actions and inactions based upon that misapprehension. Its actions and the conclusions conveyed to the Workers in the agreements and in the explanation in the information form, which accompanied the agreements, were simply an explication of what the effect of independent contractor status would be and had no separate purpose or effect aside from that explanatory function. That is to say, of course there could neither be withholding from wages nor participation in the benefit plans because those keyed on common law employment status. If the Workers were independent contractors, those would be the inevitable results, even if nothing were said about them in the agreement or the information form. Explaining the meaning of independent contractor status was simply a helpful disclosure.

Absent evidence that the officers of Microsoft used their daedalian talents to follow the first route we have just outlined,

we must decide that the second route is a more accurate portrayal of what occurred here. In other words, we should, and we do, consider what the parties did in the best light. In so doing, we do not believe that we are being panglossian; we are merely acting in accordance with the ancient maxim which assumes that "the law has been obeyed." *See, e.g.*, Cal. Civ.Code § 3548.

The evidence does not undercut our approach; it supports it. As soon as Microsoft realized that the IRS, at least, thought that the Workers were employees, it took steps to correct its error. It put some of them on its United States payroll forthwith. It also gave the Workers retroactive pay for overtime hours. If Microsoft had been withholding taxes while failing to provide benefits, that would have suggested that it knew that the Workers were a species of employee. However, its failure to withhold indicates that it did not think that the Workers were a special breed of employee; it simply thought that they were not employees at all. That was underscored when Microsoft told its managers about the status of the Workers. *See* Microsoft Manager's Handbook 4.7-4.8 (1988). It distinguished the Workers from other employees, both regular full-time and temporary. If did not say that the Workers were employees in some special category; rather, it said that they were not employees at all. *See id.*

But they were employees, which returns us to the contracts themselves. Viewed in the proper light, it can be seen that the Workers were indeed hired by Microsoft to perform services for it. We know that their services were rendered in their capacities as employees. The contracts indicate, however, that they are independent contractors, which they were not. The other terms of the contracts do not add or subtract from their status or, indeed, impose separate agreements upon them. In effect, the other terms merely warn the Workers about what happens to them if they are independent contractors. Again, those are

simply results which hinge on the status determination itself; they are not separate freestanding agreements. Therefore, the Workers were employees, who did not give up or waive their rights to be treated like all other employees under the plans. The Workers performed services for Microsoft under conditions which made them employees. They did sign agreements, which declared that they were independent contractors, but at best that declaration was due to a mutual mistake, and we know that even Microsoft does not now seek to assert that the label made them independent contractors.

On the contrary, Microsoft intended that the Workers perform services under the conditions in question, and they agreed to do so. The parties' intentions were in perfect accord in that respect, and the independent contractor label was a mere error. We see no reason to embrace and perpetuate that error. It could be argued that we would have to reform the contracts in order to elide the mutual mistake. Reformation is a concept available under the law of Washington, as it is elsewhere. *See Wilson v. Westinghouse Elec. Corp.*, 85 Wash.2d 78, 84-85, 530 P.2d 298, 301-02 (1975); *Denny's Restaurants, Inc. v. Security Union Title Ins. Co.*, 71 Wash.App. 194, 212, 859 P.2d 619, 629-30 (1993); *cf. Scott v. Petett*, 63 Wash.App. 50, 57-58, 816 P.2d 1229, 1234-35 (1991). But Microsoft saved us and the Workers the trouble of applying reformation doctrine when it agreed that the Workers were, in fact, non independent contractors. Thus, the label became meaningless, as did the explication of what would follow from that label—no withholding, no benefits.

A similar case from the Eleventh Circuit lends support to our conclusion. *See Daughtrey v. Honeywell, Inc.*, 3 F.3d 1488 (11th Cir.1993). In Daughtrey, the plaintiff had gone to work for Honeywell and had signed an agreement which stated that she was an independent contractor, that she was not an employee, and that she was not "entitled to any benefits or privileges

provided by HONEYWELL to its employees." *Id.* at 1490. She later claimed that was entitled to certain ERISA benefits because she was, in fact, an employee. The district court granted summary judgment against her on the theory that she was actually an independent contractor, but the Eleventh Circuit reversed. It did so because it found the facts to be in dispute on that status issue. It seems apparent that what made her status an issue of material fact was that she would be entitled to "employee benefits for the period during which she performed services as a consultant," if she was an employee. *Id.* at 1493. Similarly, in this case, other things remaining equal, it would appear that the Workers are entitled to the benefits of all other employees, or, at least, they are not excluded simply because of the contractual terms.

One additional matter must detain us for a moment. It could, perhaps, be argued that the statements about benefits, unlike statements about withholding, stand on their own footing as a waiver of benefits, regardless of the Workers' true status as employees. As we have said, we think that would be an incorrect interpretation of these agreements, and Microsoft assured us at argument that this is not a waiver case. Were it one, we would have to consider whether the waivers based, as they would have been, on the mistaken premise of independent contractor status were knowing and voluntary under ERISA and Washington law. *See, e.g., Laniok v. Advisory Comm.*, 935 F.2d 1360, 1367 (2d Cir.1991) (ERISA); *Yakima County (West Valley) Fire Protection Dist. No. 12 v. City of Yakima*, 122 Wash.2d 371, 384, 858 P.2d 245, 252 (1993) (Washington law). Moreover, at least as far as the SPP is concerned, we would have to consider whether the mistaken waiver must and would withstand special scrutiny designed to prevent potential employer or fiduciary abuse. *See, e.g., Sharkey v. Ultramar Energy Ltd.*, 70 F.3d 226, 230-31 (2d Cir. 1995) (close scrutiny used); *Smart v. Gillette Co. Long-Term Disability Plan*, 70 F.3d 173, 181-82 (1st Cir.1995) (careful scrutiny used); *Leavitt v.*

Northwestern Bell Tel. Co., 921 F.2d 160, 162 (8th Cir.1990) (release reviewed to assure no breach of fiduciary duty); *cf. Holt v. Winpisinger*, 811 F.2d 1532, 1541 (D.C. Cir.1987) (ERISA vesting provisions cannot be waived); *Amaro v. Continental Can Co.*, 724 F.2d 747, 752 (9th Cir.1984) (ERISA's minimum standards cannot be waived). However, these issues need not even be mooted once it is recognized that there was no separate waiver at all. Moreover, we need not consider what the result would be if the agreements were of a different form or character.

In short, Microsoft has already recognized that the Workers were employees and that the "no withholding" consequence of the independent contractor label has fallen; we now hold that the "benefit" consequence has fallen also. Having thus burned off the brumes which threatened to obscure our view, we will now turn to the plans themselves.

II. THE PLANS

A. The SPP.

The SPP is an ERISA plan. *See* 29 U.S.C. § 1002(2)(A)(ii); 26 U.S.C. § 401(k); *In re Dunn*, 988 F.2d 45, 46 (7th Cir.1933). The Workers seek enforcement of the terms of that plan. That is, they seek to have us review the determination of the plan administrator and to require that the plan make its benefits available to them. *See* 29 U.S.C. § 1132(a)(1)(B). As we have already pointed out, the administrative panel of the SPP determined that the Workers are not entitled to benefits. The reasons appear to have been that the Workers were independent contractors and that they waived the benefits. We must review those determinations to see if they were arbitrary or capricious. *See Snow*, 87 F.3d at 330. Based upon what we have already said, it is pellucid that they were. To the extent that the decision was based upon the supposed independent contractor status of

the Workers, the plan conceded that the decision was wrong when it conceded that the Workers were, in fact, employees. To the extent that the decision was based upon a supposed waiver of benefits, the plan administrator purported to construe the agreements rather than the plan itself. But, as we have pointed out, our construction is the opposite. We, therefore, determine that the reasons given for denying benefits were arbitrary and capricious because they were based upon legal errors which "misconstrued the Plan and applied a wrong standard to a benefits determination." *Saffle*, 85 F.3d at 461.

The SPP now concedes as much, but it and the Workers asked the district court, and ask us, to decide a different issue of plan construction, one on which the administrator has not opined. The district court accepted that invitation, so did the panel. *See Vizcaino I*, 97 F.3d at 1193. We are tempted to do the same, but upon reflection we have determined that we should not allow ourselves to be seduced into making a decision which belongs to the plan administrator in the first instance.

We are asked to decide what is meant by the SPP's restriction of benefits to common law employees who are "on the United States payroll of the employer." The panel explored some of the reasonably possible meanings of that phrase and construed the apparent ambiguity in favor of the Workers. *See id.* at 1193-96. No doubt the plan administrator should pay careful attention to what was said there. We have also pointed out that we are dubious about the proposition that Microsoft would manipulate plan coverage by assigning recognized common law employees to its accounts payable department or to its payroll department, as it saw fit. We have our doubts that it could properly do so. But it is the terms of the SPP which control, and the plan is separate from Microsoft itself. Thus, we cannot, and will not, predict how the plan administrator, who has the primary duty of construction, will construe terms of the SPP.

We do not know whether he will rely upon an "is" construction—you must actually be on the payroll—or upon an "ought" construction—you must be a person who should be on the payroll. Nor do we know if he will accept the domestic versus foreign gloss on the provision in question. What we do know is that the decision is his in the first instance. We would set a poor precedent were we to intrude upon that exercise of discretion before he has even considered and ruled upon the issue. We would encourage the dumping of difficult and discretionary decisions into the laps of the courts, although one of the very purposes of ERISA is to avoid that kind of complication and delay. Of course, should he rule in favor of the Workers' position, he must then go on to determine what benefits they are entitled to and under what conditions, but that, too, is exactly the kind of decision that he should be making for each of the Workers in the first instance.

We are aware of and do not resile from our decision in *Nelson v. EG &G Energy Measurements Group, Inc.*, 37 F.3d 1384 (9th Cir.1994). However, that case presented us with a somewhat unusual set of facts. In *Nelson* the Administrative Committee had not construed the particular provision, but, more than that, an attempt had been made to induce the Committee to rule on the claims, and that request was rejected out of hand. *See id.* at 1388. Moreover, while the litigation was in progress, the plaintiffs again attempted to induce the Administrative Committee to rule, but that approach was also rebuffed. *See id.* at 1388-89. Given that recalcitrance, we decided that we would determine the issue ourselves and would decide it *de novo* because there was no exercise of discretion to defer to. *See id.* at 1389. That is not this case; this is simply a case where a wholly new issue, which was never put to the SPP administrator, has been raised. He has both the right and the duty to decide it, and we must then review his ultimate decision regarding the Workers by the usual standard. "'It is not the court's function *ab initio* to apply the correct standard to [the

participant's] claim. That function, under the Plan, is reserved to the Plan administrator.'" *Saffle*, 85 F.3d at 461 (citation omitted).

B. The ESPP.

The ESPP was a plan adopted for the purpose of taking advantage of the benefits conferred under 26 U.S.C. § 423. It was approved by the board of directors and by the shareholders of Microsoft. Their action was an offer to employees, as that term is defined in § 423. As we have already suggested, we doubt that the corporate officers set out to withdraw the offer from some employees, even if they could have done that. The Workers knew about the fact of that offer, even if they were not aware of its precise terms. Under the law of the State of Washington, which all agree applies here, a contract can be accepted, even when the employee does not know its precise terms. *See Dorward v. ILWU-PMA Pension Plan*, 75 Wash.2d 478, 452 P.2d 258 (1969). In *Dorward* the court pointed out that a pension is not a gratuity, but "rather is deferred compensation for services rendered." *Id.* at 483, 452 P.2d at 261. We think that that same form of reasoning applies to all employee benefits. Few of them are mere gratuities or a result of unadulterated altruism. Most are for services rendered or for the purpose of inducing the further rendering of services. They help to guarantee a competent and happy labor force. The Washington Supreme Court went on to say:

> The consideration rendered for the promise in the pension contract of the employer to pay a pension is established when the employee is shown to have knowledge of the pension plan and continues his employment. An enforceable contract will arise in such instances even though the pensioner does not know the precise terms of the pension agreement.

Id. Again, we are confident that the court would apply the same reasoning to this employee benefit. Other of its decisions confirm us in our opinion, for it has adopted a protective view toward employees' rights. *See Bowles v. Washington Dep't of Retirement Sys.*, 121 Wash.2d 52, 67-68, 847 P.2d 440, 448 (1993) (pension benefit rights enforced for public employees, even in the absence of specific expectations); *Culinary Workers & Bartenders Union No. 596 Health & Welfare Trust v. Gateway Cafe, Inc.*, 91 Wash.2d 353, 368, 588 P.2d 1334, 1344 (1979) (pension and welfare benefit promises enforced for employees as third-party beneficiaries); *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wash.2d 911, 915, 468 P.2d 666, 669 (1970) (where employee knows that a pension plan exists, continued employment is consideration).

The ESPP was created and offered to all employees, the Workers knew of it, even if they were not aware of its precise terms, and their labor gave them a right to participate in it. Of course, Microsoft's officers would not allow that participation because they were under the misapprehension that the board and the shareholders had not extended the offer to the Workers. That error on the officers' part does not change the fact that there was an offer, which was accepted by the Workers' labor. Of course, the ESPP provides for a somewhat unusual benefit. An employee, who chooses to participate, must pay for any purchase of stock, and the Workers never did that. We, however, leave the determination of an appropriate remedy to the district court.[2]

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[2] We fully agree with the panel's disposition of Microsoft's asthenic claim that the Workers are attempting to remedy a violation of § 423 itself; we need not repeat the panel's discussion here. *See Vizcaino I*, 97 F.3d at 1197.

CONCLUSION

Microsoft, like other advanced employers, makes certain benefits available to all of its employees, who meet minimum conditions of eligibility. For some time, it did not believe that the Workers could partake of certain of those benefits because it thought that they were independent contractors. In that it was mistaken, as it now knows and concedes.

The mistake brought Microsoft difficulties with the IRS, but it has resolved those difficulties by making certain payments and by taking other actions. The mistake has also brought it difficulties with the Workers, and the time has come to resolve those.

Therefore, we now determine that the reasons for rejecting the Workers' participation in the SPP and the ESPP were invalid. Any remaining issues regarding the rights of a particular worker in the ESPP and his available remedies must be decided by the district court upon remand. However, any remaining issues regarding the right of any or all of the Workers to participate in the SPP must be decided by the plan administrator upon remand.

REVERSED and REMANDED to the district court as to the ESPP. REVERSED and REMANDED to the district court for further remand to the plan administrator as to the SPP.

FLETCHER, Circuit Judge, with whom HUG, Chief Judge, and PREGERSON, HAWKINS and THOMAS, Circuit Judges, join, concurring in part and dissenting in part:

We concur in the substance of Judge Fernandez' opinion except that we would not remand the issue of eligibility to participate in the SPP to the Plan Administrator and would hold

that the Workers are eligible to participate. Remand is inappropriate and further unnecessary in that we conclude that interpretation of the phrase "on the United States payroll of the employer" is not required.

In its denial of the Workers' claim, the administrative panel convened by the Plan Administrator stated:

> The denial is affirmed for the reasons that: (1) claimants had agreed and/or acknowledged upon first working for Microsoft that they would not receive employee benefits; (2) claimants specifically waived (by contract) any rights to benefits and (3) even if claimants had been employees and had not "waived rights to benefits," they were not "regular, full-time employees" in an approved headcount position.

We agree with Judge Fernandez that these determinations were arbitrary and capricious. On appeal, as Judge Fernandez has also properly noted, the Plan abandoned all of its prior positions in favor of a new tack: that the Workers are not eligible for SPP benefits based on a construction of the phrase "on the United States payroll of the employer." Our disagreement with Judge Fernandez, therefor, concerns (1) whether the Plan can properly raise a theory on judicial review not raised in the administrative process, and (2) if a new theory can be raised, whether the appropriate course is for the court to remand to the Plan Administrator to interpret the phrase in the first instance or for the court to decide the issue *de novo*. We would hold that the Plan waived any arguments not raised in the administrative process. Second, we conclude that because of their conduct in this litigation the defendants should be estopped from asserting that remand is appropriate. Third, were we to reach the U.S. payroll question, we would conclude that the issue was resolved by the administrative panel's factual determinations. Finally,

were we required to interpret the phrase, we would affirm the interpretation of the original three-judge panel of our court.

I.

Remand to the Plan Administrator to determine the meaning of the phrase "on the United States payroll of the employer" is improper because a plan should not be permitted to assert on judicial review reasons for denial that were not contained in the plan administrator's decision. Because it was raised for the first time before the district court, the Plan Administrator waived this argument.

An ERISA plan is required to:

> provide to every claimant who is denied a claim for benefits written notice setting forth in a manner calculated to be understood by the claimant: (1) The specific reason or reasons for the denial; (2) Specific reference to pertinent plan provisions on which the denial is based; (3) A description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary; and (4) Appropriate information as to the steps to be taken if the participant or beneficiary wishes to submit his or her claim for review. 29 C.F.R. § 2560.503-1(f).

We recently construed this requirement:

> In simple English, what this regulation calls for is a meaningful dialogue between ERISA plan administrators and their beneficiaries. If benefits are denied in whole or in part, the reason for the denial must be stated in reasonably clear language, with specific reference to the plan provisions that form the

> basis for the denial; if the plan administrators believe that more information is needed to make a reasoned decision, they must ask for it. There is nothing extraordinary about this; it's how civilized people communicate with each other regarding important matters.

Booton v. Lockheed Med. Benefit Plan, 110 F.3d 1461, 1463 (9th Cir.1997).

These regulations "are designed to afford the beneficiary an explanation of the denial of benefits that is adequate to ensure meaningful review of that denial." *Halpin v. W.W. Grainger, Inc.*, 962 F.2d 685, 689 (7th Cir.1992). The requirements "enable the claimant to prepare adequately for any further administrative review, as well as appeal to the federal courts." *Id.* (internal quotation marks omitted).

In concluding that "no plan can provide discretion to deny benefits for reasons identified only years after the fact," the Seventh Circuit noted that "[t]his Court would emasculate ERISA's disclosure requirement if it were to defer to reasons that the Board first identified on appeal in the District Court, years after the decision at issue." *Matuszak v. Torrington Co.*, 927 F.2d 320, 322-23 (7th Cir.1991).

This reasoning is sound. One of the fundamental precepts of appellate analysis is review based on a closed record. To allow a plan to raise new reasons for denial on judicial review could subject the plan participant to a cycle of multiple appeals. It would also effectively eviscerate the requirements of ERISA regulations.

In a similar context, we have held that administrative agencies are bound by the reasons stated in their FOIA denial letter and cannot conjure up new reasons on judicial review.

Friends of the Coast Fork v. United States Dep't of the Interior, 110 F.3d 53, 55 (9th Cir.1997). Because the Plan may not properly raise the U.S. payroll issue for the first time on judicial review, that issue has been waived and it is improper to remand to the Plan Administrator. Accordingly, because the Plan abandoned its other reasons for denying eligibility, the Workers should be entitled to participate in the SPP.

II.

Even if the U.S. payroll issue can be raised on judicial review, the court should decide the issue de novo rather than remanding to the Plan Administrator. We conclude that through their conduct in the litigation the defendants should be estopped from asserting that the issue is properly before the Administrator in the first instance. The defendants raised their argument that the Workers were not eligible because they were not on the "United States payroll of the employer" for the first time before the district court and urged that court, initially over the objections of the Workers, to decide the issue. The district court obliged. The defendants not only did not object to the district court deciding the question but affirmatively urged it to do so, and the Workers withdrew their objection. The Workers appealed the decision of the district court to this court. Once again, the defendants urged the court to interpret the phrase and to affirm the district court. The original panel did so but reversed the ruling of the district court and held for the Workers. Only then, after losing on the merits on appeal, in their petition for rehearing and suggestion for rehearing en banc, do the defendants for the first time argue that we should remand the question of the interpretation of the phrase "on the United States payroll of the employer" to the Plan Administrator if we are unwilling to affirm the district court. The defendants make this argument despite their failure to raise the issue during the administrative process, despite their sua sponte raising the issue and urging that it be decided by the district court, and despite

their urging that this court reach the issue on appeal. After proceeding through four years of litigation urging at every turn that the issue be decided by the court, the defendants should be estopped from asserting otherwise. *See Voliva v. Seafarers Pension Plan,* 858 F.2d 195, 197 (4th Cir. 1988) ("the party who introduced new evidence in the district court ... cannot argue that the district court was foreclosed from considering the Plan's alternative argument").

Even today the defendants are willing to have us interpret the phrase, but only if we defer to the Administrator. The defendants contend that their willingness to have the court decide the issue all along was contingent upon the court giving deference to their interpretation of the phrase because they represent the Plan. This argument is specious. Although we defer to the reasonable interpretations of a plan administrator when the plan grants the administrator discretion to construe its provisions, *see Firestone Tire & Rubber Co. v. Bruch,* 489 U.S. 101, 111, 109 S.Ct. 948, 103 L.Ed.2d 80 (1989), we do not grant the same discretion to the position taken by a plan as litigant. Where a plan administrator has not exercised his discretion to construe a provision in a plan, our review is de novo. *Nelson v. EG & G Energy Measurements Group, Inc.,* 37 F.3d 1384, 1389 (9th Cir. 1994) (de novo interpretation of plan is appropriate when, although administrative committee had discretion to do so, it failed to interpret the plan after repeated requests from participants). When conducting de novo review we "construe [the terms of a plan] without deferring to either party's interpretation." *Firestone*, 489 U.S. at 112.

III.

Were we to reach the U.S. payroll issue on de novo review, we would hold that the Workers are eligible to participate in the SPP. The case can be resolved without interpreting the Plan language. A careful review of the record before the

administrative panel convened by the Plan Administrator reveals that while the administrative panel had no occasion to construe the U.S. payroll language, it did find that the Workers had been "recharacterized, *for payroll purposes only*, ... as 'employee[s].'" (Emphasis added.) The administrative panel described this recharacterization as follows: "The effect of the IRS's recharacterization is that individuals who had worked in recharacterized positions were issued W-2 forms and they became eligible to refile their income tax returns for the relevant years as " 'employees' rather than as 'independent contractors.'"

Because the administrative panel's determination is supported by ample evidence in the record, we should accept its factual determination that the Workers were placed on the payroll of the employer, albeit retroactively, for the relevant period. *Snow v. Standard Ins. Co.,* 87 F.3d 327, 331 (9th Cir. 1996) (reviewing courts must accept the factual determinations of the administrator unless they are clearly erroneous). In light of the administrative panel's finding of fact that the Workers were on the payroll, they are eligible under the SPP regardless of how the "on the United States payroll" phrase is construed. If, as the Workers suggest, the phrase refers to those employees who are United States residents paid from United States sources, then the Workers would be eligible to participate in the Plan. Alternatively, if the defendants' construction is correct and the phrase limits benefits to those employees who were "on the payroll," then the Workers also prevail. The pleadings establish that the Workers were all United States residents and worked in the United States, and the administrative decision established that they were reclassified as employees on the payroll of the employer. Therefore, under either interpretation the Workers are eligible to participate in the SPP.

IV.

Finally, were we called upon to interpret the phrase we would agree with the conclusion of the original three-judge panel of our court that the Workers are "on the United States payroll of the employer" for substantially the same reasons advanced by the panel. *Vizcaino v. Microsoft,* 97 F.3d 1187, 1196 (9th Cir.1996).

Accordingly, we respectfully dissent from the decision to remand this aspect of the appeal back to the Plan Administrator.

O'SCANNLAIN, Circuit Judge, joined by HALL and T.G. NELSON, Circuit Judges, concurring in part and dissenting in part:

I respectfully dissent from all but Part II-A of the court's opinion because Microsoft and the plaintiffs never formed a valid contract under Washington law for the benefits now claimed. I concur in the result of Part II-A of the court's opinion but not in its analysis.

I.

I do not disagree with the court's statement of facts, but it has failed to mention some and may leave a mistaken impression of others. Thus, I suggest that the following additional facts from the record be taken into account.

The plaintiffs were temporary "freelancers" for Microsoft. Instead of calling them by this label – which was ubiquitously used within the Microsoft community and by the plaintiffs themselves – the court styles the plaintiffs as "workers." It then engages in a long discussion of why they were in fact "common law employees" of Microsoft. Both labels may be true – the

plaintiffs did work, and Microsoft has conceded that the plaintiffs satisfy the definition of common law employees for some purposes. Neither of these labels are relevant to the question before us, however, and both are potentially misleading. Both labels imply that the plaintiffs were just like any other regular Microsoft employees, and hence should be eligible for the same benefits as regular staff. The evidence in the record, however, points to the contrary. I will refer to the plaintiffs by the same term the plaintiffs themselves use: "freelancers".

Before going further, it is also important that the statement of facts identify precisely what period of activity is at issue in this case. All plaintiffs were hired before 1989. In the fall of that year, the IRS determined, for employment tax purposes, that the freelancers were common law employees. After that, in late 1989 and during 1990, Microsoft directly hired some of the freelancers as "staff"[1] (with Microsoft benefits) and arranged for the remainder to become employees of unrelated employment agencies (without Microsoft benefits) who had contracts with Microsoft.[2] For the sake of clarity, I note that all we decide today is whether the freelancers should have been allowed to participate in the ESPP and the SPP during the period leading up to the 1989-90 conversion. All agree that those freelancers who were converted into employees of outside employment agencies have no valid claim for participation in the ESPP and SPP after the date of their conversion.

When the freelancers were originally retained by contract with Microsoft, they were expressly told that they were not

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[1] "Staff" was the term Microsoft and the plaintiffs use for regular employees.

[2] As the court's opinion notes, a few of the freelancers refused to accept jobs with outside employment agencies. As a result, their relationship with Microsoft ceased altogether.

eligible for any Microsoft employee benefits, and that they would have to provide their own benefits. Indeed, the named plaintiffs admit that they did not think they were entitled to benefits, and did not think benefits were a part of their compensation package.

Moreover, the freelancers each signed contractual documents which expressly stated that they would not receive any benefits, and would have to pay their own taxes and benefits. Specifically, Microsoft required that each plaintiff sign an "Independent Contractor Agreement" ("ICA"). I think it is appropriate to set out the complete text of the relevant ICA provision:

> CONTRACTOR is an independent contractor for MS [Microsoft]. Nothing in this Agreement shall be construed as creating an employer-employee relationship, or as a guarantee of a future offer of employment. CONTRACTOR further agrees to be responsible for all federal and state taxes, withholding, social security, insurance and other benefits.

Attached to the ICA was a one-page document entitled "independent contractor/freelancer information," which the freelancers also signed. It stated:

> [A]s an Independent Contractor to Microsoft, you are self-employed and are responsible to pay all your own insurance and benefits.

In the district court, Microsoft's uncontested extrinsic evidence established that the plaintiffs were told, and knew, that benefits were not a part of their compensation. Instead of providing benefits, Microsoft paid the freelancers at a higher hourly rate than Microsoft's regular employees. The freelancers were also treated differently in a host of other ways. They had

different color employee badges, different e-mail addresses, and were not invited to company parties and functions. Instead of receiving a regular paycheck from Microsoft's Payroll department (like Microsoft's regular employees), freelancers submitted invoices for their services to the Accounts Payable department.

With these additional relevant facts in mind, we may consider the merits.

II.

As I see it, this is a simple case. The Washington law of contracts governs the freelancers' claim of entitlement to benefits under the Employee Stock Purchase Plan ("ESPP"). No law, state or federal, mandates that Microsoft provide such benefits even to its employees. Plaintiffs are eligible to participate in the ESPP only to the extent that they entered into a valid contract with Microsoft for such participation.

Offer, acceptance, and consideration are requisites to contract formation under Washington law. *Thompson v. St. Regis Paper Co.*, 102 Wash.2d 219, 685 P.2d 1081, 1087 (Wash. 1984). In order to be entitled to benefits under the ESPP, therefore, Microsoft must have offered the benefits to the freelancers, and the freelancers must have accepted that offer.

The court claims that Microsoft's board of directors offered ESPP benefits to the freelancers when they promulgated the ESPP, reasoning that an offer of benefits in a pension plan extends to and may be accepted by employees who do not know its existence, citing *Dorward v. ILWU-PMA Pension Plan*, 75 Wash.2d 478, 452 P.2d 258, 261 (Wash. 1969). The ESPP is not a pension plan, however, and, therefore, standard principles of contract law govern. Even so, as a matter of contract law, Dorward might have supported the result in this case if

Microsoft's board had merely promulgated the ESPP and the freelancers, knowing of its existence, satisfied the ESPP's eligibility requirements. But in a line of general employment law cases apparently ignored by the court's opinion, Washington courts have held that an employer revokes a generally promulgated offer when it enters into a specific agreement with an employee which is inconsistent with the offer. *Thompson v. St. Regis Paper Co.*, 102 Wash.2d 219, 685 P.2d 1081, 1087 (Wash. 1984); *Hill v. J.C. Penney, Inc.*, 70 Wash.App. 225, 852 P.2d 1111, 1117 (Wash. Ct. App. 1993); *Grimes v. Allied Stores Corp.*, 53 Wash.App. 554, 768 P.2d 528, 529-30 (Wash. Ct. App. 1989); *see also Swanson v. Liquid Air Corp.*, 118 Wash.2d 512, 826 P.2d 664, 672 (Wash. 1992) ("It is generally recognized that an employer can disclaim what might otherwise appear to be enforceable promises in handbooks or manuals or similar documents."). As a matter of standard contract law, that principle is unassailable: an offer can be revoked by giving specific notice to the offeree at any time prior to acceptance or substantial performance. *Collins v. Morgan Grain Co.*, 16 F.2d 253, 255 (9th Cir. 1926), cited with approval in 1 Arthur L. Corbin & Joseph M. Perillo, *Corbin on Contracts*, § 2.18, at 217 n. 7 (rev. ed. 1993). And, after all, the Washington Supreme Court has clearly proclaimed that the traditional requisites of contract formation apply with full force to modern, unilateral employment contracts. *Thompson*, 685 P.2d at 1087.

Exactly such a revocation occurred here. Microsoft's board offered the ESPP to employees generally, and then Microsoft told the freelancers: "We aren't offering the ESPP to you; ESPP benefits are not included in your contract." Knowing that they wouldn't get ESPP benefits, the freelancers nevertheless agreed to work for Microsoft. Their contract therefore does not include ESPP benefits because the offer of those benefits was revoked.

Likewise, there was no mutual assent (or "meeting of the minds") as is required for the formation of a unilateral contract. *See Multicare Medical Center v. State*, 114 Wash.2d 572, 790 P.2d 124, 132-33 (Wash. 1990). Microsoft did not think it was offering ESPP benefits to the freelancers, and the freelancers did not think they were accepting an offer of ESPP benefits. Had the parties known that a court would force them to include ESPP benefits in their contract, the bargain undoubtedly would have been different.

If this is not enough, the court's alleged contract suffers from another defect: a lack of consideration. There was no detrimental reliance on the ESPP by the freelancers – they did not think they would get ESPP benefits, and they still chose to work for Microsoft on Microsoft's terms. Indeed, it is hard to imagine what consideration the freelancers could have given for the ESPP benefits since they chose to work for Microsoft for several years without benefits. If anything, the freelancers received consideration (a higher hourly rate) for their agreement that they would not get ESPP benefits.

The court conjures up two reasons to disregard the express and unambiguous revocation of the offer of benefits to the workers, and to find a contract for benefits where none exists. First, the court says, the statements in the employment contracts were the result of a mistake since Microsoft's officers incorrectly thought the freelancers were independent contractors. The statements were not meant to have independent legal significance, but were "simply a helpful disclosure" explaining the meaning of independent contractor status-a status, it later turns out, that the freelancers did not have. I am unpersuaded.

The court makes this simple contracts case unnecessarily complicated, obfuscating the obvious meaning of the agreements. When one sets the ESPP side-by-side with the

agreement signed by the freelancers, one realizes that no brumes obscure the court's view of a solution to its manufactured mistake; it vainly scans the horizon for a solution which is sitting right under its nose. Microsoft drafted the ESPP and the agreements using the same terminology ("employee") to ensure there could be no mistaking that ESPP benefits were not part of the bargain. The signed agreements say: "Nothing in this Agreement shall be construed as creating an employer-employee relationship.... CONTRACTOR further agrees to be responsible for all ... benefits." These provisions are not simply a "helpful disclosure." Quite the contrary, the agreement says "CONTRACTOR further agrees ..." How much clearer could it be that this is an independent, legally binding part of the bargain? By "burning off" this inconvenient contract language, the court may as well have set fire to the contracts themselves.

To top it off, Washington courts have already rejected the court's reasoning. In *Daniel v. Pacific Northwest Bell Telephone Co.*, 20 Wash.App. 444, 580 P.2d 652, 654 (Wash.Ct.App. 1978), a worker signed a written agreement with the telephone company stating that he was an independent contractor, although under the common law definition, the worker was in fact an employee. The Washington court ruled that the common law definition was inapposite:

> It is well settled that one is bound by the contract which he voluntarily and knowingly signs. It has been said that "the whole panoply of contract law rests on ... [that] principle ..." *National Bank of Washington v. Equity Investors*, 81 Wash.2d 886, 912-13, 506 P.2d 20 (1973). For 18 years, the contract under which Mr. Daniel performed his work declared that he was an independent contractor. He does not claim that he did not understand the meaning of that term, nor does he contend that the contracts were the result of overreaching or fraud by the telephone company. In

> these circumstances, the characterization of Mr. Daniel's employment as that of an independent contractor is binding as between Mr. Daniel and the telephone company. *Id.*

This court's discussion of common law employees and mutual mistakes should be seen for what it is—a smokescreen which both confuses and conceals. Regardless of whether Microsoft and the freelancers were mistaken about the freelancers' employment status, their agreement stands on its own and ought to be enforced according to its terms.

The court's second argument, albeit not fully developed, is that under Delaware's corporations law, Microsoft's officers did not have authority to modify or to revoke the offer of the ESPP made by Microsoft's board of directors. There are two problems with this analysis.

First, as an entity without a physical existence, Microsoft can only act through its agents. *Conklin Bros., Inc. v. United States,* 986 F.2d 315, 318 (9th Cir. 1993). Under Delaware's corporations law, however, the board of directors directs the affairs of the business but is not an agent of the corporation. *Arnold v. Society for Savings Bancorp, Inc.,* 678 A.2d 533, 539-40 (Del. 1996); *see also* Restatement (Second) of Agency § 14C (1958) ("Neither the board of directors nor an individual director of a business is, as such, an agent of the corporation or of its members."). The only way to enter into a contract with Microsoft, therefore, was through Microsoft's officers and employees as agents of the corporation. It may be that the officers and employees did not have the actual authority to make a "no ESPP benefits" offer to the freelancers. They certainly had the apparent authority to strike such a bargain, however. In any event, under standard principles of agency law, if the principal ratifies unauthorized acts of its agent, the ratification relates back to the time of the acts and is equivalent to original

authority. *Hannigan v. Italo Petroleum Corp.*, 47 A.2d 169, 172 (Del. 1945). By accepting the freelancers' performance under the contract, and by choosing to defend against the freelancers' claim from 1990 until now, Microsoft's board of directors, and Microsoft itself, has impliedly ratified the "no ESPP benefits" offer. *See id.* Delaware law is therefore no obstacle to a contract for no ESPP benefits.

Second, even if the officers did not have the actual authority under Delaware corporations law to make a "no ESPP benefits" offer to the freelancers, the contract formed by the freelancers' acceptance of the offer exists nonetheless. The "no benefits" provision is an important term of the overall contract and should not be treated apart from the bargain as a whole. The freelancers cannot, with perfect hindsight, pick and choose among the parts of the contract they want to enforce while discarding the provisions they don't like, premised upon the notion that the officers lacked authority to form the contract. Furthermore, a contrary ruling undermines Delaware's carefully crafted rule that only the corporation (or a shareholder suing derivatively) can seek a remedy for unauthorized acts of corporate officers. *See Dieter v. Prime Computer, Inc.*, 681 A.2d 1068, 1072 (Del.Ch. 1996).[3]

III.

The freelancers also claim that Microsoft should have allowed them to participate in its Savings Plus Plan ("SPP"), which is governed by ERISA. The SPP provides that "[e]ach employee who is 18 years of age or older and who has been employed for six months shall be eligible to participate in this

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[3] Similarly, that the board's ratification might have adverse tax consequences for the ESPP does not allow us to ignore the overwhelming evidence that the officers and the board did not offer ESPP participation to the freelancers.

Plan." It then defines "employee" as "any common law employee who receives remuneration for personal services rendered to the employer and who is on the United States payroll of the employer." The freelancers argue that they fit this definition of employee; Microsoft retorts that the freelancers were not "on the United States payroll of the employer." Our first task, therefore, is ascertaining what that phrase means.

We cannot immediately set about this task, however, because the SPP grants discretion to the plan administrator to construe the plan. The Supreme Court has instructed us that when the plan vests discretion in the administrator, principles of trust law require that we leave the plan administrator's interpretation undisturbed if reasonable. *Firestone Tire & Rubber Co. v. Bruch,* 489 U.S. 101, 111, 109 S.Ct. 948, 103 L.Ed.2d 80 (1989). Indeed, ERISA encourages plan fiduciaries to exercise properly the discretion they have been granted; courts should not be second-guessing the discretionary decisions of fiduciaries without a very good reason. Thus, we are not to impose our view of a provision on the plan, but are confined to reviewing the administrator's instruction to determine whether it is reasonable.

In order for this rule protecting a plan administrator's discretion to be meaningful, however, the administrator must be given an opportunity to interpret the meaning of plan provisions before the court rules. In this case, the plan administrator did not overly construe the phrase "on the United States payroll of the employer," at least so far as I can tell from the record. The district court believed that the administrator impliedly rested its decision on a particular interpretation of that phrase. Although there is a colorable argument in support of the district court's belief, I believe that the judicially stated preference that the plan administrator interpret the plan, subject to a limited review by courts, requires us to remand to the plan administrator explicitly

to construe the meaning of that phrase. I agree with the court's conclusion on this point.[4]

I write separately to clarify that I do not concur in the court's analysis of the meaning and implications of "on the United States payroll of the employer," and, as dicta, the court's statements do not bind the plan administrator in any way. In my view, that phrase is a term of art with significance within the Microsoft community. Further, I do not agree with the ill-advised suggestion that Microsoft might not have been able properly to classify employees for participation or non-participation in an ERISA plan based on whether the employees were regular hires paid through the Payroll department or "freelancers" paid through the Accounts Payable department.

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[4] Judge Fletcher contends that a remand is inappropriate because (1) the Plan has waived any claim that the provision might bar benefits for the freelancers by not interpreting the Plan provision in the first instance, and (2) the Plan is estopped from arguing for a remand.

With respect, her first argument overlooks the fact that the Plan Administrator had no need to reach the question of the meaning of "on the United States payroll" since it had already determined that the freelancers were not entitled to benefits on several other grounds. I am not persuaded that by failing to interpret expressly a provision in the Plan the Administrator rendered the provision a nullity. Moreover, Judge Fletcher reads this concurrence and dissent too broadly; it does not hold that the Plan or Microsoft should prevail on the merits of an argument never raised before, but only that the Plan Administrator should be given an opportunity to construe a phrase it thought unnecessary to reach.

Judge Fletcher's second argument misapprehends, in my view, the nature of our review in this case. It is not a question of whether the Plan or Microsoft wishes us to decide the question or to remand it; a party cannot, by waiver or estoppel, change the applicable standard of review. Principles of trust law and ERISA limit our review of the Plan Administrator's discretion. We must give the Administrator an opportunity to exercise that discretion by remanding the case. Our conclusion has nothing to do with whether Microsoft urges us to decide the merits.

Microsoft could choose to offer the SPP to whichever classes of employees it wishes. It is certainly free to decide not to offer positions satisfying the SPP's criteria to these plaintiffs.

I respectfully concur in the result of Part II-A of the court's opinion but otherwise dissent.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DONNA VIZCAINO; JON R. WAITE; MARK STOUT; GEOFFREY CULBERT; LESLEY STUART; THOMAS MORGAN; ELIZABETH SPOKOINY; LARRY SPOKOINY,	)	No. 94-35770
Plaintiffs-Appellants,	)	D.C. No. CV-93-00178-CRD
v.	)	OPINION
MICROSOFT CORPORATION, and its pension and welfare benefit plans, et al.,	)	
Defendants-Appellees.	)	

Appeal from the United States District Court
for the Western District of Washington
Carolyn R. Dimmick, District Judge, Presiding

Argued and Submitted
October 18, 1995—Seattle, Washington

Filed October 3, 1996

Before: Stephen Reinhardt and Stephen S. Trott,
Circuit Judges, and William W. Schwarzer, District Judge.*

Opinion by Judge Reinhardt;
Dissent by Judge Trott

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* The Honorable William W. Schwarzer, Senior United States District Judge for the Northern District of California, sitting by designation.

COUNSEL

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James D. Oswald and Timothy St. Clair Smith, Davies, Roberts & Reid, Seattle, Washington, for the defendants-appellees.

OPINION

REINHARDT, Circuit Judge:

Large corporations have increasingly adopted the practice of hiring temporary employees or independent contractors as a means of avoiding payment of employee benefits, and thereby increasing their profits. This practice has understandably led to a number of problems, legal and otherwise. One of the legal issues that sometimes arises is exemplified by this lawsuit. The named plaintiffs, who were classified by Microsoft as independent contractors, seek to strip that label of its protective covering and to obtain for themselves certain benefits that the company provided to all of its regular or permanent employees. After certifying the named plaintiffs as representatives of a class of "common-law employees," the district court granted summary judgment to Microsoft on all counts. The named plaintiffs and the class they represent now appeal as to two of their claims: a) the claim, made pursuant to section 502(a) of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1132(a), that they are entitled to savings benefits under Microsoft's Savings Plus Plan (SPP); and b) the claim, made pursuant to Washington state law, that they are entitled to stock-option benefits under Microsoft's Employee Stock Purchase

Plan (ESPP). In both cases, the claims are based on their contention that they are common-law employees.

I

Microsoft, one of the country's fastest growing and most successful corporations and the world's largest software company, produces and sells computer software internationally. It employs a core staff of permanent employees. It categorizes them as "regular employees" and offers them a wide variety of benefits, including paid vacations, sick leave, holidays, short-term disability, group health and life insurance, and pensions, as well as the two benefits involved in this appeal. Microsoft supplements its staff of employees with a pool of individuals to whom it refused to pay fringe benefits. It previously classified these individuals as "independent contractors" or "freelancers," but prior to the filing of the action began classifying them as "temporary agency employees." Freelancers were hired when Microsoft needed to expand its workforce to meet the demands of new product schedules. The company did not provide them with any of the employee benefits regular employees receive.

The named plaintiffs worked for Microsoft in the United States between 1987 and 1990 as freelancers in the company's international division.[1] Some were still working for the

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[1] The district court certified a class comprising

> [a]ll persons employed by Microsoft Corporation in the United States who are denied employee benefits because they are considered independent contractors or employees of third-party employment agencies, but who meet the definition of Microsoft Corporation under the common law.

Microsoft did not object to the classification or contest the determination that freelancers or independent contractors are proper class members but sought to reserve the question as to whether certain specific individuals

(continued...)

company when the suit was filed in 1993, and may still be doing so today. Although hired to work on specific projects, seven of the eight named plaintiffs had worked on successive projects for a minimum of two years prior to the time the action was filed while the eighth had worked for more than a year. During that time, they performed services as software testers, production editors, proofreaders, formatters and indexers. Microsoft fully integrated the plaintiffs into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required that they work on site, they received admittance card keys, office equipment and supplies from the company.

Freelancers and regular employees, however, were not without their obvious distinctions. Freelancers wore badges of a different color, had different electronic-mail addresses, and attended a less formal orientation than that provided to regular employees. They were not permitted to assign their work to others, invited to office company functions, or paid overtime wages. In addition, they were not paid through Microsoft's payroll department. Instead, they submitted invoices for their services, documenting their hours and the projects on which they worked, and were paid through the accounts receivable department.

The plaintiffs were told when they were hired that, as freelancers, they would not be eligible for benefits. None has contended that Microsoft ever promised them any benefits individually. All eight named plaintiffs signed "Microsoft Corporation Independent Contractor Copyright Assignment and

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[1] (...continued)
fell within the class as well as the question of the amount due class members by way of benefits or damages. *See* ER at 27. *See also infra* n.4.

Non-Disclosure Agreements" (non-disclosure agreements) as well as companion documents entitled "Independent Contractor/Freelancer Information" (information documents) when first hired by Microsoft or soon thereafter. The non-disclosure agreement, a three-page document primarily concerned with confidentiality, included a provision that states that the undersigned "agrees to be responsible for all federal and state taxes, withholding, social security, insurance and other benefits." The information document likewise states that "as an Independent Contractor to Microsoft, you are self-employed and are responsible to pay all your own insurance and benefits." Eventually, the plaintiffs learned of the various benefits being provided to regular employees from speaking with them or reading various Microsoft publications concerning employee benefits.

In 1989 and 1990, the Internal Revenue Service (IRS) examined Microsoft's employment records to determine whether the company was in compliance with the tax laws. Applying common-law principles defining the employer-employee relationship, it concluded that Microsoft's freelancers were not independent contractors but employees for withholding and employment tax purposes, and that Microsoft would thereafter be required to pay withholding taxes and the employer's portion of Federal Insurance Contribution Act (FICA) tax.[2] Microsoft agreed to pay overdue employer withholding taxes and issue retroactive W-2 forms to allow the

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[2] "[B]ased on information received from Microsoft and on information received from a representative sampling of the workers in that job position," the IRS concluded in one of several letter rulings that because "Microsoft either exercised, or retained the right to exercise, direction over the services performed," those persons employed as testers were employees of Microsoft "for purposes of the Federal Insurance Contribution Act, the Federal Unemployment Tax Act, and for Collection of Income Tax at the Source on Wages." The IRS issued similar findings regarding formatters, proofreaders, and production editors.

freelancers to recover Microsoft's share of FICA taxes, which they had been required to pay. It apparently also agreed to pay freelancers retroactively for any overtime they may have worked.

In response to the IRS rulings, Microsoft began "converting" its freelancers. That is, it tendered offers to some freelancers to become permanent employees; it gave other freelancers the option of terminating their employment relationship with Microsoft completely or continuing to work at the company but in the capacity of employees of a new temporary employment agency, which would provide payroll services, withhold federal taxes, and pay the employer's portion of FICA taxes. Most of the plaintiffs who were not given the opportunity to become permanent employees decided to become "temporary agency employees" rather than to be fired. However, Donna Vizcaino refused that option and was discharged. Those who elected "temporary employee status" noticed little change in the terms or conditions of their employment; they continued working the same hours on the same projects and under the same supervisors.

After learning of the IRS rulings, the plaintiffs sought various employee benefits, including those now at issue: the ESPP and SPP benefits. The SPP, which became effective January 1, 1987, is a cash or deferred salary arrangement under § 401k of the Internal Revenue Code that permits Microsoft's employees to save and invest up to fifteen percent of their income through tax-deferred payroll deductions. Under the plan, Microsoft matches fifty percent of the employee's contribution in any year, with a maximum matching contribution of three percent of the employee's yearly compensation. The ESPP, established in January, 1986, permits employees to purchase company stock at eighty-five percent of the lower of the fair market value on the first or on the last day of each six-month offering period through payroll deductions of from two to ten

percent. Employees may purchase shares having a value not exceeding ten percent of their gross compensation for the offering period.

Microsoft rejected the plaintiffs' claims for benefits, maintaining that they were independent contractors who were personally responsible for all their own benefits. The plaintiffs sought review of the denial of benefits from the Microsoft plan administrator, who determined that the plaintiffs were ineligible because they contractually waived any rights to benefits and, in any event, they were not "'regular, full-time employees' in approved headcount positions." Although ruling "technically" only on the denial of ERISA benefits, the plan administrator concluded, for the same reasons, that the plaintiffs were ineligible to receive non-ERISA benefits.

The named plaintiffs brought this action, challenging the denial of benefits. Following cross-motions for summary judgment, the district court referred the matter to Magistrate Judge David E. Wilson, who recommended that an award be made in favor of the plaintiffs on both their SPP and ESPP claims. First, he concluded that the SPP was ambiguous with respect to whether it afforded coverage to the plaintiffs and that because the ambiguity could not be conclusively resolved by resort to extrinsic evidence, the doctrine of *contra proferentum* was applicable. Accordingly, he determined that the plan instruments should be construed in the plaintiffs' favor and recommended that the district court find that the plan afforded them coverage. Second, he concluded that by expressly adopting the conditions of the Internal Revenue Code, which permit tax qualification only to those plans that extend participation to all common-law employees, Microsoft had extended an offer of participation in the ESPP to all common-law employees, and that the plaintiffs fell into that category. Further, he found that although Microsoft had intended to exclude freelancers from participation in the ESPP, it had made the plaintiffs an offer in

that plan and could not rely on their failure to accept it because it had incorrectly told them that they were ineligible to participate. Again, the magistrate judge recommended that the district court find that the plaintiffs were eligible for benefits.

The magistrate judge also made recommendations on several motions relating to benefits other than the SPP and ESPP. Specifically, he recommended denying the plaintiffs' motion for summary judgment in relation to vacation, sick leave, holidays, short-term disability, group health and life insurance, and granting Microsoft's motion for summary judgment on all claims governed by ERISA, except the SPP claim, and on all claims governed by state law, except the ESPP claim.

The district court adopted the magistrate judge's recommendations on all issues other than the SPP and ESPP claims. It rejected his recommendations as to those two claims and denied the plaintiffs' motion for summary judgment as to them, while granting Microsoft's. The district court first concluded that the SPP "clearly restricts participation to those individuals on Microsoft's payroll," that even if Microsoft could waive the argument that only employees paid through the payroll were eligible it had not done so, and that because the intent of the parties was to deny the plaintiffs participation, the terms of the plan were susceptible to only one reasonable interpretation. Thus, it said, the doctrine of *contra proferentum* was not applicable. Then, addressing the plaintiffs' eligibility to participate in the ESPP, the district court concluded:

> First, the contract between Microsoft and the plaintiffs specifically stated that no benefits were provided by Microsoft. Second, because the terms of the plan were not communicated to the plaintiffs, they could not have become part of the contract between them and Microsoft. Thus, the plaintiffs had no expectation of

receiving any benefits. Finally, as Microsoft asserts, I.R.C. § 423 does not create a private right of action by the plaintiffs against Microsoft.

The named plaintiffs and the class they represent appeal, but only with respect to the SPP and ESPP claims.

II

ERISA is a remedial statute designed to protect the interests of employees in pension and welfare benefit plans. *Scott v. Gulf Oil Corp.*, 754 F.2d 1499, 1501 (9th Cir. 1985). It creates a federal cause of action for recovery of benefits due under the terms of pension and welfare plans. 29 U.S.C. § 1132(a)(1)(B).[3] Congress intended the courts to fashion a body of federal common law to govern ERISA suits. *Richardson v. Pension Plan of Bethlehem Steel*, 67 F.3d 1462, 1465 (9th Cir. 1995); *Scott*, 754 F.2d at 1501-02. Courts, therefore, may borrow from state law where appropriate, but must be guided by the policies expressed in ERISA and other federal labor laws. *Richardson*, 67 F.3d at 1465; *Scott*, 754 F.2d at 1502.

The parties agree that the SPP is a welfare benefits plan governed by ERISA. *See* 29 U.S.C. § 1002(1)(A). They disagree, however, on the question whether the plaintiffs qualify for benefits under the terms of the plan. The SPP provides that "[e]ach employee who is 18 years of age or older and who has been employed for six months shall be eligible to participate in this Plan," and defines "employee" to mean "*any common-law employee* who receives remuneration for personal services rendered to the employer and *who is on the United States payroll of the employer*." (Emphasis added). Because the named

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[3] Section 1132(a)(1)(B) provides, in pertinent part, that a "civil action may be brought . . . by a participant or beneficiary . . . to recover benefits due to him *under the terms of the plan* . . . ." (Emphasis added).

plaintiffs were indisputably over eighteen years of age and were employed for more than six months, and because, as Microsoft concedes, they were generally common-law employees who rendered personal services to Microsoft,[4] the issue before us is only whether they were "on the United States payroll of the employer." Microsoft contends that the phrase, which is not defined in the plan, refers to employees paid through its payroll department, and that the named plaintiffs were ineligible to participate in the SPP because they were paid through the accounts receivable department. The plaintiffs assert that the phrase refers to "Microsoft employees who are paid from United States sources," excluding "nonresident alien employees of foreign subsidiaries whose pensions are generally governed by foreign law."

In the usual case, we review a denial of benefits challenged under section 1132(a)(1)(B) *de novo* "unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan." *Nelson v. EG & G Energy Measurements Group, Inc.*, 37 F.3d 1384, 1388 (9th Cir. 1994).[5] Where such discretion is

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[4] As the magistrate judge stated in his Report and Recommendations, Microsoft conceded the fact that the named plaintiffs and the class they represent generally were common-law employees. ER at 144, 147-48. *See also supra* n.1. Microsoft reserved only the right to object to the employment status of particular plaintiffs during certain periods of their tenure with Microsoft and to contest the amount of damages or benefits to be awarded. CR Vol. 12, Document 152, at 9 n.5. For example, Microsoft stated that "for some period of time, Plaintiff Morgan performed proofreading services from his home, with an uncertain amount of supervision." *Id.* Questions raising legitimate disputes regarding specific individuals' eligibility are left to the district court for resolution following remand.

[5] When the plan does not grant the plan administrator discretion to construe its provisions, the district court reviews *de novo*, and our review is also *de novo*. *Mongeluzo v. Baxter Travenol Long Term Disability*

(continued...)

afforded, the standard of review may vary with the type or nature of the plan. *Taft v. Equitable Life Assurance Soc'y*, 9 F.3d 1469, 1474 (9th Cir. 1993) (stating that we review decisions of administrators who are also employers of plan beneficiaries under "'a more stringent version of the abuse of discretion standard' ") (citation omitted).

In the case before us, the administrator is a Microsoft officer. We need not, however, determine what standard would ordinarily be applicable to review of a denial of benefits under the SPP. For, while the plan gives the administrator discretion to construe its provisions, in denying the plaintiffs' claims the administrator did not construe the phrase "on the United States payroll of the employer," the phrase in the plan on which eligibility depends. Oddly, Microsoft did not raise its "United States payroll" theory before the plan administrator but argued it for the first time to the magistrate judge in the course of its motion for summary judgement.[6] The plaintiffs initially objected to consideration of the "United States payroll" argument because it did not appear in the administrative record, but then waived the objection and, like Microsoft, urged the magistrate judge and the district judge to address it. Both parties have consistently maintained that a remand to the plan administrator would serve no useful purpose. *See* CR Vol. 12, Document 152, at 22-23; CR. Vol. 12, Document 169, at 12 n.ll. Because both parties urged the district court, and now this court, to determine the meaning of the disputed provision, they have waived any possible objection to the failure to remand. Accordingly, we are free to decide Microsoft's latest argument in the normal course, as if the plan administrator had no

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[5] (...continued)
Benefit Plan, 46 F.3d 938, 942 (9th Cir. 1995).

[6] Microsoft prevailed before the plan administrator on the theory that the plaintiffs were not "regular, full-time employees" in "approved headcount positions," a theory that it has since abandoned.

discretion to construe the plan. *Cf. Nelson*, 37 F.3d at 1389 (holding that our review is *de novo* where the plan administrator, although having discretion to construe the plan, has not done so).[7]

We interpret the provisions of a plan by looking to its terms and to other manifestations of intent. *Nelson*, 37 F.3d at 1389. We interpret terms in ERISA plans "'in an ordinary and popular sense as would a [person] of average intelligence and experience.' " *Richardson*, 67 F.3d at 1465 (quoting *Evans v. Safeco Life Ins. Co.*, 916 F.2d 1437, 1441 (9th Cir. 1990)); *Babikian v. Paul Revere Life Ins. Co.*, 63 F.3d 837, 840 (9th Cir. 1995); *accord Meredith v. Allsteel Incorp.*, 11 F.3d 1354, 1358 (7th Cir. 1993). "'We will not artificially create ambiguity where none exists. If a reasonable interpretation favors the insurer and any other interpretation would be strained, no compulsion exists to torture or twist the language of the policy.'" *Babikian*, 63 F.3d at 840 (quoting *Evans*, 916 F.2d at 1441 (quoting *Allstate Ins. Co. v. Ellison*, 757 F.2d 1042, 1044 (9th Cir. 1985))). We find "[a] term is ambiguous if it is subject to reasonable alternative interpretations." *Hickey v. A.E. Staley Mfg.*, 995 F.2d 1385, 1389 (9th Cir. 1993) (citation and internal quotation marks omitted); *see Babikian*, 63 F.3d at 840.

When a plan is ambiguous on its face, we may, and typically do, consider extrinsic evidence to interpret it.

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[7] This case is not controlled by *Saffle v. Sierra Pacific Power Company*, 85 F.3d 455 (9th Cir. 1996). There, we held that where a plan administrator misconstrues a plan, the court should not determine whether benefits are to be awarded under a proper construction; instead, it should remand to the plan administrator for it to make a determination under the plan, properly construed. Here, the term that determines the plaintiff's eligibility was not construed at all by the plan administrator. More important, both parties have agreed that a remand would be inappropriate. The parties are, of course, free to waive any right they may have to a construction by a plan administrator.

Richardson, 67 F.3d at 1466; *Hickey*, 995 F.2d at 1389. If the ambiguity persists even after resort to extrinsic evidence, we generally apply the rule of *contra proferentum* and construe the ambiguity against the drafter. *See Barnes v. Independent Auto. Dealers of Cal.*, 64 F.3d 1389, 1393 (9th Cir. 1995) ("We must construe ambiguities in an ERISA plan against the drafter and in favor of the insured."); *Babikian*, 63 F.3d at 840; *Mongeluzo v. Baxter Travenol Long Term Disability Benefit Plan*, 46 F.3d 938, 942 (9th Cir. 1995) (noting that *Kunin v. Benefit Trust Life Ins. Co.*, 910 F.2d 534, 539-41 (9th Cir.), *cert. denied*, 498 U.S. 1013 (1990), adopted the well-established doctrine of *contra proferentum* as federal common law).

Accordingly, our first task is to determine whether the phrase "on the United States payroll of the employer" is susceptible to more than one reasonable interpretation. In doing so, we must examine the phrase in light of any relevant circumstances that may shed light on its meaning. Here, the phrase is used in connection with a company that is engaged in a constantly expanding business venture of major proportions on a world-wide basis. Because "payroll" means "a list of persons to be paid, with the amount due each," or "the total number of people employed by a business firm or organization," Random House College Dictionary 976 (1980), the phrase "on the United States payroll of the employer," when accorded its ordinary meaning, may plausibly refer to those persons who are on the list of, or are among the total number of, persons employed by Microsoft and paid from its United States accounts, as opposed to those paid by its foreign subsidiaries or out of its foreign accounts. Thus, we believe that the plan, consistent with the ordinary meaning of its terms, reasonably can be read to extend eligibility to the plaintiffs.[8]

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[8] There may be a slight variation on the interpretation set forth above that is equally plausible and would similarly serve to extend eligibility to the

(continued...)

While an argument could well be made that the plaintiffs' is the only plausible reading of the plan, we choose not to rely on that assertion. Instead, we assume that Microsoft's interpretation is also a reasonable one, and accept its contention that the phrase could reasonably be construed to refer only to those employees paid through the payroll department. Assuming, then, that the terms of the SPP are susceptible to two reasonable interpretations and therefore are ambiguous, our next step is to determine whether the ambiguity can be resolved by resort to extrinsic evidence.

Microsoft contends that the extrinsic evidence, including the non-disclosure agreements and the information documents, demonstrates its intent not to provide freelancers or independent contractors with employee benefits and that this intent necessitates adoption of its interpretation of the disputed phrase. We have no doubt that the company did not intend to provide freelancers or independent contractors with employee benefits, and that if the plaintiffs had in fact been freelancers or independent contractors, they would not be eligible under the plan. The plaintiffs, however, were not freelancers or independent contractors. They were common-law employees,[9] and the question is what, if anything, Microsoft intended with respect to persons who were actually common-law employees

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[8] (...continued)
plaintiffs. Under that variation, the disputed phrase would be construed as referring to all persons employed by Microsoft in the United States. However, we need not examine that possibility here.

[9] The instruments signed by the plaintiffs label them as independent contractors. Those instruments, however, do not control the plaintiffs' employment status. *See Daughtrey v. Honeywell*, 3 F.3d 1488, 1492 (11th Cir. 1993) ("The employment status of an individual for the purpose of ERISA is not determined by the label used in the contract between the parties."). Accordingly, the label used here does not determine whether the plaintiffs are or are not common-law employees. The record does, and as Microsoft has conceded, the named plaintiffs and those they represent are generally common-law employees.

but were not known to Microsoft to be such. The fact that Microsoft did not intend to provide benefits to persons who it thought were freelancers or independent contractors sheds little or no light on that question. To the extent that we may glean any evidence of an intent as to the more pertinent theoretical question, that evidence is highly speculative and would be insufficient to resolve in Microsoft's favor the ambiguity that it created when it chose to define eligibility in terms of common-law employees "on the United States payroll of the employer."

Microsoft also contends that extrinsic evidence establishes its intent to restrict eligibility to those common-law employees who were paid through the payroll department. It argues that compliance with relevant tax code provisions (I.R.C. §§ 401(k) & (m)) required computation of compensation, deferral, and matching contribution data, and that the necessary computations could practically be made only through its automated payroll department. It maintains that employees who were paid through the accounts receivable department, as opposed to the payroll department, could not be paid in a manner that would comply with IRS requirements and that, accordingly, it is clear that those employees were not intended to be covered in the plan.

Microsoft's argument, drawing a distinction between common-law employees on the basis of the manner in which they were paid, is subject to the same vice as its more general argument. Microsoft regarded the plaintiffs as independent contractors during the relevant period and learned of their common-law employee status only after the IRS examination. They were paid through the accounts receivable department rather than the payroll department because of Microsoft's mistaken view as to their legal status. Accordingly, Microsoft cannot now contend that the fact that they were paid through the accounts receivable department demonstrates that the company intended to deny them the benefits received by all common-law

employees regardless of their actual employment status. Indeed, Microsoft has pointed to no evidence suggesting that it ever denied eligibility to any employees, whom it understood to be common-law employees, by paying them through the accounts receivable department or otherwise.

In any event, to interpret the SPP as distinguishing between common-law employees who were paid through the payroll department and those who were not would impute to Microsoft an unlawful purpose: to pay some common-law employees without making the requisite payroll deductions and contributions, the very tax violation that subsequently engendered this litigation. We should not, if at all possible, favor an interpretation that has such an unlawful effect, and we see no reason to do so here. *See Meredith v. Allsteel, Inc.*, 11 F.3d 1354, 1358 (7th Cir. 1993) ("[A]n interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect[.]") (citation and internal quotation marks omitted). Thus, the extrinsic evidence on which Microsoft relies does nor resolve the ambiguity in its favor.

In light of the rule of *contra proferentum*, the plaintiffs would prevail whether the extrinsic evidence supported their interpretation of the disputed phrase or whether the extrinsic evidence on which they rely was also deemed immaterial. For purposes of our disposition, we may assume the latter to be the case. With that assumption in mind, we find, as did the magistrate judge, that "the correct meaning of the terms in question, given the record and the agreed upon facts in this case, cannot be determined by resort to the extrinsic evidence," and that, therefore, the rule of *contra proferentum* is applicable.

Microsoft contends that the rule of *contra proferentum* should not be applied in this case because it has been applied generally in ERISA cases only for the purpose of granting

benefits under insurance contracts Microsoft is incorrect. It is true that the rule of *contra proferentum*, which is strictly applied in the interpretation of insurance contracts, is not automatically applied to *all* other contracts. *Eley v. Boeing Co.*, 945 F.2d 276, 280 (9th Cir. 1991). We have declined to apply the rule to "ERISA plans that are the product of collective bargaining agreements reached after arms-length bargaining between parties of equal power." *Patterson v. Hughes Aircraft Co.*, 11 F.3d 948, 950 n.3 (9th Cir. 1993); *see Eley*, 945 F.2d at 280 (distinguishing *Kunin* because the plan was the result of a collective bargaining agreement); *see also Kunin*, 910 F.2d at 540. This case does not involve such a plan, and we see no reason to create a new exception to the rule we generally follow in ERISA cases. *See Barnes*, 64 F.3d at 1393.

We have also held that when an administrator has exercised his discretion to construe a plan pursuant to discretionary authority vested in him by the plan, we will not apply the rule of *contra proferentum* in our review of his discretionary ruling. *Winters v. Costco Wholesale Corporation*, 49 F.3d 550, 554 (9th Cir. 1995). Microsoft argues that this case falls within this exception. Clearly, it would be inconsistent to review under an abuse of discretion standard and then to apply the rule of *contra proferentum*. However, as we explained earlier, the administrator did not construe the disputed terms of the plan, and therefore our review is *de novo*. When we review under a *de novo* standard, there is no similar inconsistency, and thus no reason not to apply the rule of *contra proferentum*.

Accordingly, we agree with the magistrate judge, who concluded that Microsoft, "[a]s the drafter of the plan, . . . could easily have accomplished the limitation it now urges through the use of more explicit language. . . ." We therefore construe the ambiguity in the plan against Microsoft and hold that the plaintiffs are eligible to participate under the terms of the SPP. We note that in doing so, we construe the phrase "on the United

States payroll of the employer" in the manner we believe to be the most plausible anyway. Put more directly, were we not to apply the rule of *contra proferentum*, but simply to select the more reasonable of the competing interpretations, we would read the disputed phrase as do the plaintiffs. Thus, we would conclude in any event that the plan must be construed as extending participation to all persons employed by Microsoft and paid from its United State accounts, and not as excluding from participation those employees who are paid through the accounts receivable department rather than the payroll department.

III

The parties agree that the plaintiffs' claims for stock-option benefits under the ESPP are not subject to ERISA but rather are governed by Washington state law. The plaintiffs contend that the ESPP, through its incorporation of § 423 of the Internal Revenue Code, extended eligibility to participant in the plan to all common-law employees, including themselves, and that they were therefore entitled to exercise the options. Microsoft contends that the plaintiffs are not enticed to ESPP benefits because: (1) the plaintiffs have no right to enforce § 423; (2) the plaintiffs signed instruments stating that they would receive no benefits; and (3) the ESPP was never communicated to the plaintiffs, and they therefore did not rely on the offer in continuing their employment. We address these contentions in turn.

First, we hold that the named plaintiffs and the class they represent are covered by the specific provisions of the ESPP. We apply the "objective manifestation theory of contracts," which requires us to "impute an intention corresponding to the reasonable meaning of a person's words and acts." *Multicare Medical Ctr. v. D.S.H.S.*, 790 P.2d 124, 133 (Wash. 1990). Through its incorporation of the tax code provision into the

plan, Microsoft manifested an objective intent to make all common-law employees, and hence the plaintiffs, eligible for participation. The ESPP specifically provides:

> It is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1954. *The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section of the Code.*

(Emphasis added). The requirements of § 423 dictate that "options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation." 26 U.S.C. § 423(b)(4). Because the term "employees" in § 423 is construed to refer to "common-law employees,"[10] the ESPP, when construed in a manner consistent with the requirements of § 423, extends participation to all common-law employees not covered by one of the express exceptions set forth in the plan.[11] Accordingly, we

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[10] Treasury Regulation § 1.423-1(b) cross-references § 1.421-7(h) for rules relating to the employment relationship. That subsection, in turn, provides that the determination whether an optionee is an employee will be made in accordance with § 3401(c)-1(a), which states that the term "employee" includes every individual performing services for another where the legal relationship between the two is that of employer and employee. Section 31.3401(c)-l(b) summarizes the common-law test of employee, and § 31.3401(c)-1(c) provides that where the legal relationship exists, the labels used by the parties to describe the relationship are of no consequence.

[11] Section 423(b)(4) sets forth four express exceptions. The ESPP incorporates two of them, as follows:

> [a]ny employee of the Company or any of its subsidiaries who is in the employ of the Company at one of the offering dates is

(continued...)

find that the ESPP, through its incorporation of § 423, expressly extends eligibility for participation to the plaintiff class and affords them the same options to acquire stock in the corporation as all other employees.

Microsoft argues that § 423 does not grant the plaintiffs a private right of enforcement. We conclude, as did the magistrate judge, that Microsoft's argument is without merit. This case is not about a private right of action. It is about the construction of the terms of a plan. As the magistrate judge cogently stated,

> Plaintiffs do not contend that § 423, *per se*, provides them with a private right of enforcement. What they *do* contend is that Microsoft expressly incorporated § 423's terms into its ESPP, thereby making an offer to its employees, including its "common law employees," a classification in which they belonged.

Because the plan, properly construed, extends participation to all common-law employees, the plaintiffs may enforce the plan in the same manner as would any of Microsoft's other employees. They may, and did, assert a cause of action for breach of contract, not for violation of the Internal Revenue Code.[12]

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[11] (...continued)
eligible to participate in the Plan, except (a) employees whose customary employment is 20 hours or less per week, and (b) employees whose customary employment is for not more than five months in the calendar year.

The plaintiffs fit neither of these exceptions.

[12] A similar approach obtains with respect to plans that require compliance with the provisions of ERISA. While Internal Revenue Code provisions and Treasury regulations do not create substantive rights under ERISA, if an ERISA plan explicitly provides that it is to be construed to meet such provisions, courts look to them in determining employee eligibility (continued...)

Microsoft next contends that the non-disclosure agreements and the information documents signed by the plaintiffs render them ineligible to participate in the ESPP. First, the label used in the instruments signed by the plaintiffs does not control their employment status.[13] Second, the employment instruments, if construed to exclude the plaintiffs from receiving ESPP benefits, would conflict with the plan's express incorporation of § 423. Although Microsoft may have generally intended to exclude individuals who were in fact independent contractors, it could not, consistent with its express intention to extend participation in the ESPP to all common-law employees, have excluded the plaintiffs. Indeed, such an exclusion would defeat the purpose of including § 423 in the plan, because the

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[12] (...continued)
for participation in the plan. *See Crouch v. Mo-Kan Iron Workers Welfare Fund*, 740 F.2d 805, 809 (10th Cir. 1984) ("Because the pension plan states that it is to be construed to meet the requirements of ERISA, [the participating and vesting rules require the inclusion of a person in plaintiff's position in the plan,] and there are obvious and significant benefits to meeting those requirements, we conclude that we must construe the plan as including plaintiff as a participant."); *see also Abraham v. Exxon Corp.*, 85 F.3d 1126, 1131 (5th Cir. 1996) (finding that court could not look to Treasury regulations to determine employee eligibility for participation in an ERISA plan when it did not contain an explicit provision "declaring that it was to be construed to meet the requirements of an ERISA plan").

[13] The pertinent Treasury Department regulation provides that

> [i]f the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, *independent contractor*, or the like.

Treas. Reg. § 31.3401(c)-1(e) (emphasis added). Accordingly, that the instruments describe the plaintiffs as independent contractors and provide that as such they are not entitled to benefits is not controlling.

exclusion of common-law employees not otherwise excepted would result in the loss of the plan's tax qualification.

Moreover, we find nothing inconsistent between the employment instruments signed by the plaintiffs, and an offer of participation in the ESPP. The statements in those instruments that speak in terms of the employee being "responsible for . . . other benefits" or "responsible to pay all [his] own insurance and benefits" apply most naturally to health and welfare benefits, or similar employee protection policies, which an employee would have to pay on his own if the employer did not provide the benefits. In fact, we find the instruments fully consistent with the plaintiffs' participation in the ESPP, because, under the terms of the plan, it is the employee who makes the stock option payment, not Microsoft. Thus, it *is* the employee who is "responsible" for paying for the benefit. Accordingly, even if the incorporation of § 423 did not override the instruments signed by the plaintiffs, we would conclude that nothing in those instruments serves to waive or otherwise foreclose the plaintiffs' eligibility for participation in the ESPP.[14]

Finally, Microsoft maintains that the plaintiffs are not entitled to ESPP benefits because the terms of the plan were never communicated to them and they were therefore unaware of its provisions when they performed their employment services. As a preliminary matter, we find Microsoft's reliance on policy manual cases such as *Kimbro v. Atlantic Richfield Company*, 889 F.2d 869, 879 (9th Cir. 1989), to be misplaced. In *Kimbro*, we stated that under Washington precedent, an employer may be contractually bound by promises in employee

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[14] For this reason, Microsoft's reliance on *Grimes v. Allied Stores Corporation*, 768 P.2d 528, 529 (Wash. Ct. App. 1989), in which the court considered a conflict between an employment contract and an employment manual, is inapposite.

handbooks or manuals to provide specific treatment in specific situations only if an employee can show that the promise induced his reliance—that is, "that the promise induced him to remain on the job or not seek other employment." 889 F.2d at 879 (quoting *Thompson v. St. Regis Paper Co.*, 685 P.2d 1081. 1088 (Wash. 1984)). However, many policy manuals are primarily designed for internal guidance and such manuals are far different in nature and legal effect than tax-qualified benefit plans that fix the rights of their beneficiaries.[15]

In any event, to the extent that knowledge of an offer of benefits is a prerequisite, it is probably sufficient that Microsoft publicly promulgated the plan. In *Dangott v. ASG Industries, Inc.*, 558 P.2d 379, 382 (Okla. 1976), the plaintiff was unaware of the company's severance plan until shortly before his termination. The Oklahoma Supreme Court concluded nonetheless that publication of the plan was "the equivalent of constructive knowledge on the part of *all* employees not specifically excluded." *Id.* at 383 (emphasis added).[16] Here, the plaintiffs knew of the plan but were wrongly told by Microsoft that it did not apply to them. We are not aware of any Washington case involving a similar set of circumstances, but think it likely that if presented with the question, the

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[15] Washington case law regarding pension plans, for example, holds that "[a]n enforceable contract will arise . . . even though the [employee] does not know the precise terms of the pension agreement. *"Dorward v. ILWU-PMA Pension Plan*, 452 P.2d 258, 260 (Wash. 1969).

[16] *See Woolley v. Hoffman-LaRoche, Inc.*, 491 A.2d 1257, 1268 n.10 (N.J. 1985) ("The implication of the presumption of reliance is that the . . . provisions became binding the moment the [plan] was distributed. Anyone employed before or after became one of the beneficiaries of those provisions. And if [*Toussaint v. Blue Cross & Blue Shield*, 292 N.W.2d 880 (Mich. 1980)] is followed, employees neither had to read it, know of its existence, or rely on it to benefit from its provisions . . . ."); *see also* A. Corbin, *Contracts* § 59 (1963) (suggesting that knowledge of an offer is not necessary to establish acceptance).

Washington Supreme Court would adopt the *Dangott* approach, at least under the circumstances presented in this case.

Microsoft itself recognizes "the key distinction between offers actually made to a class of employees, as to which some courts enforce the offer on behalf of *any* class member, regardless of individual knowledge of the offer, and plans as to which no offer is made to the class, and the class is expressly notified no offer is being made." (Emphasis added). Here, the plan was distributed to Microsoft employees generally. By its terms, the plan extends participation to the class of common-law employees, and hence offers ESPP benefits to all members of that class.[17] Thus, applying the "key" distinction recognized by Microsoft, an offer was actually made to a class of employees of which the plaintiffs were a part, and it may be enforced on their behalf regardless of their individual knowledge regarding the offer.

We are not required to rely, however, on the *Dangott* analysis or even on Microsoft's own unwitting concession. There is a compelling reason, implicit in some of the preceding discussion, that requires us to reject the company's theory that the plaintiffs' entitlement to ESPP benefits is defeated by their

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[17] Microsoft contends that despite promulgation of a plan, no rights are created unless a promise is made directly to the affected employees. The two cases cited by Microsoft in support of this proposition, *Estate of Bogley v. United States*, 514 F.2d 1027 (Ct. Cl. 1975), and *Schmidt v. Avco*, 472 N.E.2d 721 (Ohio Ct. App.), *aff'd*, 473 N.E.2d 822 (1984), are readily distinguishable. In *Bogley*, a corporate board of directors voted to offer the plaintiff a severance plan but never actually offered it to him. In *Schmidt*, there was no allegation that the severance pay policy was published or generally distributed to Avco employees. We also reject Microsoft's argument that the plaintiffs represent a separate class. The plaintiff class is a subset of the class of common-law employees as to whom Microsoft failed to honor its promise of benefits. That the plaintiffs were wronged in this manner hardly makes them a separate class for purposes of determining the scope of the promise.

previous lack of knowledge regarding their rights. It is "well established" that an option or may not rely on an optionee's failure to exercise an option when he has committed any act or failed to perform any duty "calculated to cause the optionee to delay in exercising the right." 17A Am. Jur. 2d *Contracts* § 85 (1991 & Supp. 1996). "[T]he option or may not make statements or representations calculated to cause delay, [or] fail to furnish [necessary] information. . . ." *Id.* Similarly, "[I]t is a principle of fundamental justice that if a promisor is himself the cause of the failure of performance, either of an obligation due him or of a condition upon which his own liability depends, he cannot take advantage of the failure." *Highlands Plaza, Inc. v. Viking Investment Corp.*, 435 P.2d 669, 676 (Wash. 1967) (quoting 5 *Williston on Contracts* § 617 (3d ed. 1961); *James S. Black & Co. v. P & R Co.*, 530 P.2d 722, 724 (Wash. Ct. App. 1975) (same); *Refrigeration Eng'g Co. v. McKay*, 486 P.2d 304, 309 (Wash. Ct. App. 1971) (same); *see Restatement of Contracts* § 295 (1932).

Applying these principles, we agree with the magistrate judge, who concluded that Microsoft, which created a benefit to which the plaintiffs were entitled, could not defend itself by arguing that the plaintiffs were unaware of the benefit, when its own false representations precluded them from gaining that knowledge. Because Microsoft misrepresented both the plaintiffs' actual employment status and their eligibility to participate in the ESPP, it is responsible for their failure to know that they were covered by the terms of the offer. It may not now take advantage of that failure to defeat the plaintiffs' rights to ESPP benefits. Thus, we reject Microsoft's final argument.

CONCLUSION

For the reasons stated, the district court's grant of summary judgment in favor of Microsoft and denial of summary judgment in favor of the plaintiffs is REVERSED and the case REMANDED for the determination of any questions of individual eligibility for benefits that may remain following issuance of this opinion and for calculation of the damages or benefits due the various class members.

REVERSED and REMANDED.

TROTT, Circuit Judge, Dissenting:

I

The Savings Plus Plan

Microsoft has a *payroll* department, and it has a separate *accounts payable* department. Because these plaintiffs were regarded both by Microsoft *and* by themselves as independent contractors or freelancers, Microsoft did not budget or pay for them through the payroll department, but through the accounts payable department. This commonplace distinction is fatal to the plaintiff's request for Savings Plus Plan ("SPP") benefits because to be eligible for these benefits, they have to have been on the employer's "payroll." The Plan itself so states.

As freelancers, the plaintiffs worked for Microsoft with the clear understanding that they were not entitled to the benefits they now seek: They knew Microsoft paid them based on the submission of invoices and out of accounts payable. Nevertheless, they now contend—without a foot to stand on—that they were indeed on Microsoft's "payroll" and thus eligible for SPP benefits. In my reading of this record, they were

not on Microsoft's "payroll," period. I agree with the district court's analysis. All this may seem formalistic to the casual reader, but it was an important distinction to Microsoft, and to these workers when they agreed as freelancers to perform work for this company.

How the plaintiffs got on Microsoft's payroll budget from the accounts payable department is a strange tale based not on the facts, but on an immaculate patching together by the majority of a series of interpretations, constructions, presumptions, plausibilities, assertions, and assumptions, topped off by an irrelevant definition of "payroll" in a Random House dictionary. This amalgam is driven in turn by an IRS ruling that the majority takes way beyond its necessary reach. The majority's strained and Urbanesque journey belies its claim that it does not create ambiguity where none exists. In the context of this case—forget Random House—"payroll" has an ascertainable meaning illustrated in large measure by the existence in Microsoft of an alternative method of paying people for their work: out of accounts payable. Anyone familiar with business is familiar with this distinction. Where is the ambiguity but in the eyes of uninitiated outsiders? I discern none, and the plaintiffs saw none either when they voluntarily worked under these circumstances.

As the majority indicates, we interpret terms in ERISA plans "in an ordinary and popular sense as would a person of average intelligence and experience," but we should do so with an eye to what those hypothetical people actually know (e.g., that they did not bargain for the payroll benefits they now seek). To do otherwise is to engage in head-in-the-sand thinking. All the maxims invoked by the majority to support their holdings are useless unless they square with the facts. If I know I have a "no benefits" contract, for example, what good does it do to ask what the ordinary average Babbitt (George, not Bruce) might believe after reading a Random House dictionary? These

plaintiffs were university-educated. One had a law degree. They knew what they were getting into, and *contra proferentem* should not suggest otherwise. The majority's preference for answering this issue as a theoretical rather than a real question is wrong.

But for the sake of argument, we can ignore the contextual definition of "payroll" and concede the existence of an ambiguity created by the words "United States." Then we can examine extrinsic evidence to see if the plaintiffs have a righteous claim to this benefit. Here their argument becomes tenuous in the extreme. The plaintiffs have not presented a shred of relevant extrinsic evidence that would justify *their* belief (after signing the documents they did and after accepting the contractual relationship governing this case) that they were on the payroll and entitled to any of the payroll benefits of regular employees, including the SPP. Plaintiff Vizcaino's answers in her deposition testimony, answers representative of the testimony of all plaintiffs, adequately illustrate this point:

> Q. You didn't ask anything [during your initial interview] about the benefits on this job?
>
> A. Well, yeah, I must have I guess. 1 don't remember what we said but I guess it—yeah, *we weren't going to get benefits at that time.*
>
> Q. Okay. And just so we understand each other, when you say benefits—let me rephrase the question. By benefits I assume that you mean, and correct me if I'm wrong, things like holidays, vacation, sick leave, other kinds of paid leave, participation in the employee stock purchase plans, that kind of thing. Is that the way you mean benefits?

A. Yeah.

Q. Okay. Now, at the end of this conversation, this interview with Ms. Carter, I assume it was at the end of the conversation, did you accept the position on the terms that had been discussed in that interview?

A. Yes.

(emphasis added). Equally telling is the deposition testimony of plaintiff Culbert:

Q. Did you ever hear anybody use the term "regular employee" during your time at Microsoft when you were a freelancer?

A. I do recall, yes.

Q. And when that term was used did you understand it to refer to *people who were salaried as opposed to freelancers*?

A. Yes.

Q. So that until this status change [when Culbert became a regular employee] in October of 1989 you were never a regular employee at Microsoft?

A. I worked at Microsoft consistently.

Q. But you were never what was referred to as a regular employee?

A. That's correct. I was never what was referred to as a regular employee at that time, correct.

Q. And I take it at no time before October of 1989 did you ever apply for benefits of any type from Microsoft: sick leave, vacation, holidays, participation in the employee stock purchase program?

A. I didn't apply for those things.

* * * *

Q. But during the course of the next few weeks or months [after beginning work at Microsoft] it became clear to you that being a freelancer meant that you got no benefits?

A. That it meant something, if I may, it meant that in some ways *I was different from the regular salaried employees with whom I worked.*

Q. But *among those ways of which it made [sic] you different was that you got no benefits*?

A. Correct.

(emphasis added). In the light of this testimony, this case becomes just another example of litigants trying to force their feet into glass slippers that do not fit. As the magistrate judge correctly observed, these plaintiffs had express contracts for "no benefits."

Why they would accept such an arrangement *without* benefits is also clear from the record: Microsoft paid them more *cash* on an hourly basis than regular employees. Plaintiff Culbert explains:

Q. Did you have any understanding at that time [when you became a regular employee of Microsoft] about whether it was common for freelancers to be making more on an hourly basis than the equivalent hourly rate for people who were regular salaried employees?

A. Yes.

Q. What was your understanding?

A. That in general freelance production editor [sic] on a gross cash basis would stand to make more than a regular staff employee.

Nevertheless, the plaintiffs brought this lawsuit pursuing not only SPP and stock purchase benefits, but vacation, sick leave, holidays, short-term disability, and group health and life insurance as well, i.e., the best of both worlds.

With all respect to my colleagues, their atmospheric use of the IRS's determination to shore up their analysis by suggesting Microsoft is a tax cheat is gratuitous and inappropriate. I do not discern on the part of Microsoft an unlawful purpose to violate the tax laws. What the IRS does for the purpose of collecting its due—both early and from the most reliable pocket—need not cast a dark light on a relationship with which both Microsoft and these employees were comfortable. It simply does not follow either from the IRS's ruling or from Microsoft's compliance with it (1) that these plaintiffs were *payroll* employees *or* (2) that to deny the plaintiffs' claim gives Microsoft unacceptably unclean hands. To quote the United States General Accounting Office in June of 1996,

> [M]any employers struggle in making the [employee/independent contractor] classification

> decision because of the unclear rules. Until the classification rules are clarified, we are not optimistic that the confusion over who is an independent contractor and who is an employee can be avoided. The Treasury Department characterized the situation in 1991 in the same terms as it used in 1982; namely, that "applying the [20 factor] common law test in employment tax issues does not yield clear, consistent, or satisfactory answers, and reasonable persons may differ as to the correct classification."[1]

As the magistrate judge observed, "[p]laintiffs concede that the IRS ruling . . . is in no way binding on this court." The IRS's familiar aggressive tax collection position and Microsoft's payroll argument can exist independently of each other without doing violence to the law.[2]

By tone and by choice of words the majority seems subtly to accuse Microsoft of reprehensible conduct towards its workers. Microsoft is identified as "refusing" to pay its workers fringe benefits as though it did something wrong in creating the contractual relationships in this case. Later in the opinion the majority charges Microsoft with "misrepresenting" to the plaintiffs their employment status and with taking advantage of them. They clothe Microsoft with a Dickensian anti-labor

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[1] General Accounting Office, Pub. No. GAO/T-GGD-96-130, *Tax Administration: Issues in Classifying Workers as Employees or Independent Contractors* 5 (1996) (statement of Natwar M. Gandhi, Associate Director, Tax Policy and Administration. Issues, General Government Division).

[2] Because independent contractors have been found by the IRS to have a lower compliance rate than employees in paying their taxes—to the tune of two to three *billion* dollars a year—the IRS adopted an aggressive enforcement program in 1986 resulting to date in 12,983 Employment Tax Examination Program audits and the reclassification of 527,000 workers. *Id.*

attitude. Such characterizations spring full-bloom from the first sentence of the majority's opinion where "avoiding payment of employee benefits" and "increasing profits" foreshadow the negative coloration of the infidel Microsoft's role in this drama. The majority's tone and accusations go against the factual record as developed and described by the magistrate judge in his Report and Recommendation dated April 15, 1994:

> Plaintiffs offer the explanation that Microsoft really knew all along that they were regular "employees" entitled to benefits, and hid this entitlement from them by "mislabeling" them as independent contractors or freelancers. *This argument is not persuasive.* "Mislabeling" as used by Plaintiffs implies a unilateral act by Microsoft which in some way hid their true status from Plaintiffs. *In truth, Microsoft was quite open about the terms of its working relationships with Plaintiffs on the subject of employee benefits* and *each of the Plaintiffs fully understood and accepted those terms.*

(emphasis added).

Neither federal nor state law mandates the benefits sought, nor does the applicable collective bargaining agreement. Microsoft was free to offer the benefits in return for work as Microsoft saw fit. Thus, the majority seems to overlook the constitutional right of private parties freely to enter into contracts of their own choice and benefit. It is not for the courts under these circumstances to add clauses to agreements that the parties never contemplated, or to accuse parties of attitudes and behavior of which they are not guilty. Congress designed ERISA to protect benefits workers already had, not to give them benefits for which they did not contract. *See* 18 U.S.C. § 1001 (Congressional findings and declaration of policy).

II

The Employee Stock Purchase Plan

The plaintiffs' second claim of entitlement is to stock option benefits under Microsoft's Employee Stock Purchase Plan ("ESPP"), a claim we process under the law of the State of Washington. The law in question is the Washington law of *contracts*.

As with the plaintiffs' first claim, the majority engages in analytical gymnastics to find a contractual right where none exists. No one disputes that the offer made by Microsoft and accepted by the plaintiffs explicitly excluded the ESPP benefits now sought. Plaintiffs freely admit as demonstrated earlier that they never expected when these contracts were formed to receive any such benefits. Microsoft never offered the benefits to the plaintiffs, either bilaterally or unilaterally, the plaintiffs never accepted them, and the plaintiffs never relied on them in any way whatsoever as part of their compensation package. As the magistrate judge found in his Report and Recommendation,

> Microsoft indeed offered such benefits to its "regular employees" and described them in employee handbooks issued to regular employees, but not to freelancers. Moreover, it is not contended by any Plaintiff that he/she was ever offered such benefits by any Microsoft spokesperson, or even a handbook, and to the extent that any of them saw the books, they understood that they were *not entitled* to them.

Thus, without an offer, without acceptance, without consideration, and without a meeting of the minds, the majority creates by operation of law a contractual right on behalf of these plaintiffs that they never even contemplated until this lawsuit began.

This unpredictable result is so radical that it trespasses on Article I, section 10, Clause 1 of the Constitution, which prohibits a state from impairing the obligation of contracts. Neither through legislation nor by judicial act could a state severely transmogrify a contractual obligation in this manner and force one party to it to confer such benefits on the other. The result in this case resembles the thrust of the Minnesota statute struck down by the Supreme Court in *Allied Structural Steel Co. v. Spannus*, 438 U.S. 234 (1978). In that case, Minnesota had enacted a law requiring certain private employers who provided pension benefits under a plan meeting the qualifications of section 401 of the Internal Revenue Code to provide pension benefits "conspicuously beyond those that [the company] had voluntarily agreed to undertake." *Id.* at 420. The Supreme Court held this statute unconstitutional under the contracts clause (1) because it failed to deal with a "broad, generalized economic or social problem," and (2) because of its narrow aim at only certain employers. The Court noted also in the employer's favor (1) that the employees of Allied Structural never relied on the statutory benefit at issue, and (2) that the statute "compelled the employer to exceed bargained-for expectations and nullified an express term of the pension plan." *Id.* at 246 n.18. Justice Stewart said,

> The severity of an impairment of contractual obligations can be measured by the factors that reflect the high value the framers placed on the protection of private contracts. Contracts enable individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.

Id. at 245.[3] Because we are bound to apply state law to this dispute, we have no authority to impair the obligation of these contracts either. To do so is tantamount to depriving Microsoft of property without due process of law.

CONCLUSION

The IRS's understandably tough enforcement program not only collects more money for the government, but it now has the unforeseen and unnecessary consequence of forcing employers retroactively to extend to workers optional benefits for which they did not contract. I perceive no need whatsoever to permit the IRS's ruling to spill out of its unique context and to do damage to contracts between companies and workers. The ruling and the contracts can exist independently of each other. Peaceful coexistence simply means that all workers will be made to pay their taxes, no more, no less, and that all workers will get that for which they bargained. Thus, I respectfully dissent.

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[3] *See also Associated Builders & Contracts, Golden Gate Chapter v. Baca*, 769 F. Supp. 1537 (N.D. Cal. 1991) (holding that municipal legislation requiring contractors to pay minimum wages and benefits in order to receive private building permits unconstitutionally impaired the contractors' collective bargaining contracts).

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

DONNA VIZCAINO, JON R. WAITE, MARK STOUT, GEOFFREY CULBERT, LESLEY STUART, THOMAS MORGAN, ELIZABETH SPOKOINY and LARRY SPOKOINY,	)	No. C93-178D
Plaintiffs,	)	ORDER
v.	)	
MICROSOFT CORPORATION, and its health and benefit plans: Health Benefit Plan, Life Insurance Plan, Short-term and Long-term Disability Plans, and Savings (401K) Plan,	)	
Defendants.	)	

THIS MATTER comes before the Court on a Report and Recommendation filed on April 15, 1994, by the Honorable David E. Wilson, United States Magistrate Judge. The Court, having considered the Report and Recommendation, the objections thereto, and the entire record, hereby adopts the Report and Recommendation in part and declines to adopt the Report and Recommendations as discussed below.

In the Report and Recommendation (the "Report"), Magistrate Wilson recommends that the Court grant Microsoft's motion with regard to all contract claims except those that pertain to the Employee Stock Purchase Plan (the "ESPP"). As

to the latter claims, Magistrate Wilson recommends that the Court grant plaintiffs' motion for summary judgment. The Court believes that all of the claims presented by the instant summary judgment motions must be decided under state contract law. Accordingly, summary judgment on all claims, including the ESPP claim, is granted in favor of Microsoft.

I

The facts are detailed in the Report and will not be repeated here in detail. *See* Report at 3-12. Basically, plaintiffs were hired by Microsoft as either "independent contractors," "temporary agency employees," and "freelancers." At the time of his or her employment, or shortly thereafter, each plaintiff signed a document stating that he or she was responsible for his or her own benefits. During each plaintiff's tenure at Microsoft, he or she was treated differently than Microsoft's "regular employees" in terms of benefits, working conditions, and training. Plaintiffs filed this suit to recover benefits that Microsoft offered to its regular employees. This motion pertains to the plaintiffs' claim to benefits including paid vacation, paid sick leave, paid holidays, disability benefits, and entitlement to enroll in the ESPP.

II

The benefits at issue in this motion are not mandated by any federal or state statute or a collective bargaining agreement. These benefits arise, if at all, under state contract law. In recommending that summary judgment in favor of Microsoft on all state law claims except the ESPP claims should be granted, the Report correctly looks to the express agreement that each plaintiff entered with Microsoft. The Report concludes that the employment contract does not entitle any plaintiff to benefits.

> The bilateral express agreements (the ICA's) between the parties plainly state that Plaintiffs were responsible for their own "benefits." While some Plaintiffs claim they did not read the agreements carefully, all concede that they knew they were not entitled to benefits. If they did not know it from the first day of their relationship, they knew it very shortly thereafter, and continued working at Microsoft. It may be true, as some Plaintiffs complain, that Microsoft presented the documents on a "take it or leave it" basis, but Microsoft had a right to do so, and Plaintiffs had a right to refuse the terms offered.

Report at 19. Accordingly, the Report recommends that all claims based on contract law, except those relating to the ESPP, be resolved in Microsoft's favor. The Court adopts the portion of the Report so far as it discusses the plaintiffs' claims relating to paid vacation, paid sick leave, paid holidays, and disability benefits. Summary judgment in favor of Microsoft is hereby granted on those claims.

III

The Report reaches a contrary result in regards to the state law claim of entitlement to the ESPP benefit even though it recognizes that entitlement to participate in the ESPP is governed by state contract law. Report at 28. The language of the Report follows:

> [T]he right to participate in [the ESPP], like the right to obtain the other employee benefits which is the subject of the instant motions, is governed by state contract law.

* * * *

> The uncontested evidence is thus that Microsoft never expressly offered the ESPP benefit to Plaintiffs, and no plaintiff had any expectation of receiving it as a portion of his/her compensation for any services performed by any Plaintiff as a freelancer on behalf of Microsoft. Rather, all Plaintiffs understood that they would *not* receive the benefit.
>
> Given this admitted clear understanding between Plaintiffs and Microsoft that Plaintiffs would receive *no* employee benefits, the Washington state law of contracts discussed above with respect to the *other* benefits which are the subject of these motions, would normally dictate resolution of the issue of the ESPP benefit in favor of Microsoft.

Report at 28-30. In spite of these statements, the Report concludes that the plaintiffs are entitled to ESPP benefits because in its plan, Microsoft stated an intent to have the ESPP conform to I.R.C. § 423.

The Court must reject the Report as to this issue for the following reasons. First, the contract between Microsoft and the plaintiffs specifically stated that no benefits were provided by Microsoft. Second, because the terms of the plan were not communicated to the plaintiffs, they could not have become part of the contract between them and Microsoft. Thus, the plaintiffs had no expectation of receiving any benefits, including ESPP benefits. Finally, as Microsoft asserts, I.R.C. § 423 does not create a right of action by the plaintiffs against Microsoft. *See Trenton v. Scott Paper Co.*, 832 F.2d 806, 810 (3d Cir. 1987), *cert. denied*, 485 U.S. 1022 (1988); *Reklau v. Merchants Nat'l Corp.*, 808 F.2d 628, 631 (7th Cir. 1986), *cert. denied*, 481 U.S. 1049 (1987); *Bryant v. Food Lion, Inc.*, 774 F. Supp. 1484, 1491 n.4 (D.S.C. 1991); *In re Witwer*, 148 B.R. 930, (Bankr. C.D. Cal. 1992), *aff'd without opinion*, 163 B.R. 614 (Bankr.

9th Cir. 1994). Section 423 does not require Microsoft to open its plan to all employees; rather, Section 423 conditions beneficial tax treatment of employees who are participants upon the plan allowing participation of all employees. Accordingly, Section 423 may not be used to create a right of action by the plaintiffs. Consequently, Microsoft is entitled to summary judgment on this claim.

In summary, the Court adopts the Report and Recommendation to the extent that the Report and Recommendation grants summary judgment in favor of Microsoft. Accordingly, the plaintiffs' motion for partial summary judgment on vacation, paid sick leave, paid holidays, and disability benefits is DENIED; plaintiffs' motion for partial summary judgment on eligibility to participate in the Employee Stock Purchase Plan is DENIED; Microsoft's motion for partial summary judgment on claims governed by state law (including the claim relating to the ESPP) is GRANTED. The Clerk of the Court is directed to send copies of this Order to all counsel of record and to Judge Wilson.

DATED this 20th day of June, 1994.

CAROLYN R. DIMMICK
United States District Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

DONNA VIZCAINO, et al.,	)	No. C93-178D
	)	
Plaintiffs,	)	REPORT AND
	)	RECOMMENDATION
v.	)	ON PLAINTIFFS'
	)	MOTION FOR PARTIAL
MICROSOFT, et al.	)	SUMMARY JUDGMENT
	)	
Defendants.	)	

INTRODUCTION

Plaintiffs have filed a "Motion for Partial Summary Judgment on Vacation, Sick Leave, Holidays, and Short-Term Disability Leave" issues. Plaintiffs have also filed a Motion for Partial Summary Judgment on Eligibility to Participate in Employee Stock Purchase Plan ("ESPP"). Defendants have filed a cross "Motion for Partial Summary Judgment on State Law Claims," in which Defendants contend that all of those benefits which are the subjects of Plaintiffs' two motions are governed by state law, and that Defendants are entitled to summary judgment as to all benefits sought in Plaintiffs' two motions. (The parties have filed additional motions for partial summary judgment on other aspects of the case, including those claims by Plaintiffs governed by ERISA. The remaining motions will be addressed in a separate Report and Recommendation(s).)

Having reviewed the cross motions, the memoranda in support of the motions, the responses thereto, the replies to the responses, the numerous supporting documents filed by each

side, and the record and files in this case, it is my recommendation that the Court find that Defendant Microsoft is entitled to partial summary judgment on the questions in issue, with the exception of the issue of participation in the ESPP, as to which I recommend that partial summary judgment be entered for Plaintiffs. Accordingly, I recommend that the Court: *grant* Defendants' Motion for Partial Summary Judgment on State Law Claims except as to the ESPP; *grant* Plaintiffs' Motion for Partial Summary Judgment on Eligibility to Participate in the Employee Stock Purchase Plan; and *deny* Plaintiffs' Motion for Partial Summary Judgment on Vacation, Sick Leave, Holidays, and Short Term Disability Leave.

FACTS

There are no material facts in dispute.

Defendant Microsoft is a large corporation engaged in the production an sale of computer software on an international basis. Microsoft initially produces its software products in an English format, and thereafter produces formats and accompanying user manuals in other languages for sale abroad. Microsoft has a core staff of permanent employees, some of whom work full-time and some of whom work part-time, which it categorizes as it "regular employees."[1] Those employees are

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[1] During all times that the Plaintiffs and their class were working at Microsoft, Microsoft defined "regular . . . employees" who were paid on an hourly basis, as employees "filling an approved, budgeted position." (Microsoft Nonexempt Employee Handbook (Hourly)). The definition is contained in excerpts from the handbook in its 1985-88 and 1989 versions, set out as Exhibits 18 and 19, to Defendants Memorandum in Support of Motion for Partial Summary Judgment on State Law Claims.

The handbooks clearly stated that only "regular" employees received benefits. *(Id.)* All of the Plaintiffs admit that they were familiar with this concept that benefits were so limited. *See*, p. 17, note 10 to Defendants'

(continued...)

offered a number of employee benefits, including the benefits which are the subject of these motions.[2]

In addition to its "regular employees," Microsoft, during all time material to these motions, utilized the services of other individuals for various segments of time, who were classified as "independent contractors," "temporary agency employees," and/or "freelancers." The most commonly used of these terms by both Microsoft and the named Plaintiffs was "freelancers." All of the Plaintiffs were classified by Microsoft (and considered themselves) "freelancers" during their respective working relationships with Microsoft. "Freelancers" were persons working at Microsoft in either "independent contractor" or "temporary agency employee" statuses, who did not receive employee benefits.[3] Freelancers were assigned jobs such as "production editors," "proofreaders," "formatters," "indexers," and "testers." From Microsoft's viewpoint, obtaining the services of freelancers satisfied a production need by providing it with access to a workforce capable of quick expansion or contraction. This "accordion" capability was important because the staffing needs required to produce foreign language software products were uncertain as to beginning dates, duration, and ending dates. The services of freelancers could be obtained on a non-permanent basis, and terminated when the specific project

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[1] (...continued)
Memorandum in Opposition to Motion for Partial Summary Judgment on Vacation, Sick Leave, Holidays and Short Term Disability Leave.

[2] The starting benefits offered "regular employees" at Microsoft include ten (10) paid holidays, ten (10) days paid sick leave, and two (2) weeks paid vacation, as well as a form of short term disability leave.

[3] Microsoft notes the following dictionary definition of "freelance": one who pursues a profession or occupation usually in the arts under no long term contractual commitment to one company." *Webster's Third New International Dictionary of the English Language Unabridged.* (Def. Reply Memorandum in Support of Motion for Partial Summary Judgment on State Law Claims at 7, n.1).

for which they were engaged was completed. (Declaration of Karin L. Carter in Support of Defendants' Motion for Summary Judgment, January 28, 1994 ("Dec. Karin Carter") ("Def. Mot. Sum. Judg.")).

Microsoft in fact developed a "pool" of individuals available for such work, and due to the continuing press of work, was able to engage some freelances for successive projects with no breaks in work. Some of the pool were ultimately hired as regular employees of Microsoft, after working in one or more of the above classifications for various lengths of time. (Dec. Karin Carter).

Each of the named Plaintiffs began their working relationship with Microsoft as a freelancer and held one of the above-described job titles. They worked as freelancers during the period 1987 - 1990. Seven of the eight worked for 2 years or more, one worked for more than one year. They represent the following class:

> All persons employed by the Microsoft Corporation in the United States who are denied employee benefits because they are considered independent contractors or employees of third-party employment agencies, but who meet the definition of employees of the Microsoft Corporation under the common law. This definition includes all such persons so employed within the applicable statute of limitations.

Some of the named Plaintiffs (and some class members), were subsequently hired by Microsoft as "regular employees." During the period(s) when the respective Plaintiffs were working in one of the freelancer classifications, they were not provided the employee benefits which are the subjects of these motions, *i.e.*, paid vacation, sick leave, holidays, and short term

disability leave, all of which Microsoft provided to its "regular employees" during those same periods.[4]

The named Plaintiffs are all university-educated individuals, most, if not all of whom, have foreign language skills. Some have graduate degrees or have attended graduate school. One (Larry Spokoiny) is a law school graduate and member of the Washington State Bar.

All of the named Plaintiffs were aware that they were engaged by Microsoft to work in one of the freelancer categories, and that under the terms of their working relationship with Microsoft, they were not entitled to employee benefits unless they obtained regular employee or "staff" status as a result of being offered and accepting "permanent" employment with Microsoft. All apparently referred to themselves as "freelancers," whether they had an "independent contractor" agreement with Microsoft, or after 1989, when Microsoft converted a number of them to employees of "temporary agencies," to comply with an IRS ruling *(infra)*. All referred to permanent or "regular employees" as "staff," in contrast to "freelancers."

None of the named Plaintiffs contends that as a freelancer he/she was ever promised employee benefits by any Microsoft spokesperson, and none ever applied for any employee benefits while working in one of the excluded classifications. Of the eight (8) named Plaintiffs, six (6), upon first engaging to perform services for Microsoft, signed one or more documents entitled "Microsoft Corporation Independent Contractor Copyright Assignment and Non-Disclosure Agreement,"

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[4] Microsoft contends that it had no "Short Term Disability Plan," as identified by Plaintiffs, but concedes that it provided such a benefit through its payroll practice, and that entitlement to that benefit is also determined by state law. (Defendant's Memorandum in Support of Partial Summary Judgment on Claims Governed by State Law at 3-4.)

("ICA") which, on its face, appeared to expressly state that each Plaintiff and Microsoft agreed that he/she would *not* be entitled to employee benefits.[5] The other two named Plaintiffs (Donna Vizcaino and Gregory Cuthbert), signed the same documents shortly after Microsoft began requiring all persons so situated to execute the document. (Each, Vizcaino and Cuthbert, admitted that he/she was aware even before signing the ICA that he/she would not receive any employee benefits as a result of work performed for Microsoft as a "freelancer."[6])

Persons working on Microsoft projects as freelancers, often worked side by side with "regular" staff who were doing work

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[5] Each Plaintiff signed an ICA which identified the Plaintiff as a "Contractor," and stated at paragraph 9:

> CONTRACTOR . . . further agrees to be responsible for all federal and state taxes, withholding, social security, insurance *and other benefits*.
>
> (Emphasis supplied.)

Each of the Plaintiffs has attached copies of his/her ICA to the respective "Declaration" he/she submitted with Plaintiffs' instant motion.

In addition, each Plaintiff also signed at approximately the same time as the ICA was signed, a one page companion document entitled "INDEPENDENT CONTRACTOR/FREELANCER INFORMATION." That document begins with the following statement:

> Operating as an Independent Contractor/Freelancer the following applies:
>
> 1. That as an Independent Contractor to Microsoft, you are self-employed and are responsible to pay all your own insurance *and benefits*. You have acknowledged this by signing the Copyright Assignment and Nondisclosure Agreement with Microsoft.

An example of this second document is attached to Defendants' Memorandum as "Exhibit A."

[6] *See* note 17, *infra*, setting out portions of the depositions of Plaintiffs Vizcaino and Cuthbert.

identical to that of the "freelancers." Freelancers often worked on teams made up of both "freelancers" and "staff" employees, which were headed by staff supervisors, but where the work performed by the team apparently was assigned to team members without regard to the classification of the team members.

Both freelancers and staff enjoyed limited flexibility in their working hours, but were generally expected to be present during "core hours" of roughly 10:00 a.m. to 3:00 p.m., Monday through Friday. Freelancers, who received no vacation or sick leave, could take vacations *without* pay, and were expected to call in if unable to work due to illness. They had no paid sick leave. They were not paid for holidays.

Freelancers were paid on an hourly basis, with the rate of pay varying by individual and being set during initial interviews with Microsoft supervisory personnel. The hourly rate was often increased by Microsoft based on the traditional concepts of productivity, after the freelancer had worked for a while. The hourly pay rate for freelancers sometimes translated into a higher annual pay rate than if the freelancers had been salaried "staff" employees, with the result being that those freelancers who subsequently obtained regular employment with Microsoft, sometimes took a reduction in pay when they became salaried employees.[7] The employee benefits, upon gaining employee status, however, were generally considered sufficiently attractive as to more than make up for any loss in the pay rate occasioned by becoming "staff." By the terms of their agreements with Microsoft, Plaintiffs as freelancers or independent contractors, were required to not only arrange for their own benefits, but to be responsible for paying their federal

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[7] *See, e.g., see* note 17, *infra,* re: Gregory Cuthbert's testimony on this subject.

income taxes and both portions (employer and employee) of their FICA taxes.

Freelancers were not paid out of Microsoft's payroll budget, but were paid out of the company's Accounts Payable Department, and were required to complete invoices for their services, which were submitted to the company. Those freelancers who were converted from "independent contractors" to employees of temporary agencies after the IRS ruling in 1989, were paid by those agencies, who in turn billed Microsoft for the cost of their services.

In addition to a different pay system, Microsoft treated its regular employees and the freelancers differently in a number of other ways which were obvious to all. While new regular employees were given an orientation to the company, which included a handbook and information on employee benefits, freelancers were not given the same orientation or handbooks, but were given a shorter and less formal briefing by those with whom they would be working. The handbooks were not treated confidentially, and some Plaintiffs saw them around the company campus. To the extent that any of the freelancers were casually exposed to the publications, however, they knew that the benefits described in them were not available to the freelancers.

Freelancers were given different color key cards and passes from those issued staff. In most instances, regular employees or staff had private offices or cubicles, while freelancers shared office space in pairs, although occasionally a freelancer obtained a private work space. Freelancers had different E-mail "aliases" from those given staff; the freelancer's electronic identifications began with a "C," for contractor, or a "T," for temporary agency employee. Freelancers were not invited to official company functions such as the annual meeting, the company picnic, or the

company Christmas party (although some attended as guests of staff).

While freelancers often worked on teams with staff employees doing identical work, the supervisors of such teams or groups were always staff personnel as opposed to freelancers. Although freelancers occasionally received brief additional training after their initial orientation, staff employees received more regular and lengthy continuing training. Staff employees were subject to an "elaborate" (Declaration of Jon Waite) periodic employee review process, while freelancers were not, and instead received a less formal review of their work.

In the fall of 1989, the Internal Revenue Service ("IRS") ruled in a series of letters and determinations that Plaintiffs and other freelancers then working under "independent contractor" arrangements with Microsoft, were not truly independent contractors, but were instead "*employees for federal tax purposes*."[8] Applying common law concepts of the term "employee," the IRS's administrative ruling concluded that the "independent contractors" were "employees" *for tax purposes*, and that thereafter Microsoft would be required to withhold taxes on compensation paid them, and pay the employer's portion of the FICA tax.

In response to the IRS ruling, Microsoft made offers of employment to some of the "independent contractors," who accepted and became regular employees of Microsoft. As to the remaining freelancers, Microsoft gave them the option of "converting" their status to that of employees of several temporary employee agencies (e.g., "Volt" and "Manus"). The temporary employment agencies provided payroll services for the converting freelancers, withholding federal taxes and paying

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[8] App. B, Plaintiffs' Opening Brief on Vacation and Other Paid Leave Benefits at 004294-004307, 004195, 006034.

the employer's portion of the FICA tax. The agencies in turn invoiced Microsoft for the services of the freelancers. Plaintiffs thus "converted" noticed little, if any, change in their working conditions or their relationship with Microsoft. No employee benefits were provided those freelancers who chose to convert from "independent contractor" status to "temporary agency employee" status. Most of the Plaintiffs elected to convert to temporary agency employee status, given the alternatives of *no* work relationship with Microsoft. Plaintiff Vizcaino refused to convert and had her independent contractor status terminated by Microsoft.[9]

Thereafter, Plaintiffs obtained counsel and formally sought the employee benefits now in issue from Microsoft. Microsoft refused, and this lawsuit followed.

DISCUSSION

All parties agree that Plaintiffs' entitlement to the employee benefits in issue in *these* motions, in contrast to certain other motions in this case now pending before the Court, are governed by state contract law.[10] Plaintiffs concede that the IRS ruling that they were "employees for federal tax purposes" is in no way binding on this Court in its resolution of the issue of their entitlement to the employee benefits offered by Microsoft to its regular employees. The parties' briefing on this issue is extensive and thorough, and occasionally refers to and discusses various cases in the broad arena of employment law, which includes "benefits" and other issues covered under such statutes

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[9] The respective personnel histories of the named Plaintiffs while at Microsoft are set out in Plaintiffs' Brief in Opposition to Microsoft's Motion for Summary Judgment on ERISA Claims, at 13-17.

[10] Plaintiffs' Brief in Support of Partial Summary Judgment on Vacation, Sick Leave, Holidays and Short-Term Disability Leave at 8; Defendant's Memorandum in Support of Motion for Partial Summary Judgment on Claims Governed by State Law at 1.

as ERISA and the FELA, and certain state statutes mandating benefit coverage of certain categories of employees.

It is important to stress at the outset that the benefits which Plaintiffs seek here are *not* mandated by any federal or state statute. There is, for example, no state statute requiring employers to provide employee benefits of the types sought here, if the facts of one's work at an employer's facility satisfy a "common law employee" test, similar to the test utilized by the IRS to define the relationship for federal tax purposes. Neither were the benefits now sought covered by any collective bargaining agreement in effect between Plaintiffs and Microsoft. There were no collective bargaining agreements between or on behalf of Microsoft and any group which included Plaintiffs.

The sole question before the Court is thus whether, under Washington State contract law, Plaintiffs were entitled to employee benefits from Microsoft by reason of an agreement(s) between themselves and Microsoft, either express or implied.

Summary judgment is appropriate if, viewing the evidence in the light most favorable to the party opposing the motion, there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. *Swayze v. United States*, 785 F.2d 715, 717 (9th Cir. 1986) (citing Fed. R. Civ. P. 56(c)). To deny a motion for summary judgment, the court need conclude only that a result other than proposed by the moving party is possible under the facts and applicable law. *Aronsen v. Crown Zellerbach*, 662 F.2d 584, 591 (9th Cir. 1981), *cert. denied,* 459 U.S. 1200 (1983).

When a motion for summary judgment is made and supported as provided in Fed. R. Civ. P. 56, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavit, or as otherwise provided

in Rule 56, must set forth specific facts showing that there is a genuine issue for trial. Fed. R. Civ. P. 56(e).

A. PARTIAL SUMMARY JUDGMENT IS APPROPRIATE FOR MICROSOFT AS TO ALL STATE LAW BENEFITS EXCEPT FOR THE EMPLOYEE STOCK PURCHASE PLAN.

Microsoft takes the position that the Court need only look to the individual Independent Contractor Agreements ("ICA") signed by each Plaintiff, which expressly provide that the individual is responsible for his/her own benefits, to answer the question posed and to rule for Defendants.[11] Microsoft contends that the agreements were freely entered into by Plaintiffs, all of whom are university-educated professional people, and one of whom, in addition, is a member of the Washington State Bar. Microsoft urges that the Court should not, under Washington State contract law, go beyond the clear wording of the ICA's, since parol evidence is not admissible in the face of a written agreement, citing *Daniel v. Pacific Northwest Bell Tel. Co.*, 20 Wn. App. 444, 580 P.2d 652, *review denied,* 90 Wn. 2d 1025 (1978).

Microsoft further argues that even if the Court accepts parol evidence as to the agreements here, that evidence will clearly show: that all Plaintiffs admit that no one in a position of authority ever promised them benefits; that they admit that they understood either from the moment they began working at Microsoft, or very shortly thereafter, that they would not receive employee benefits; that as a consequence of that understanding none ever applied for such benefits; and that there is no aspect of the governing Washington state law on contracts which would offer Plaintiffs the relief they seek. Microsoft urges that

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[11] As noted, each named Plaintiff executed at least two documents to this effect.

the IRS' conclusion that Plaintiffs were "employees" for tax purposes, in no way altered the remainder of their working agreements with the company, which expressly provided that the company was not responsible for their benefits. Microsoft contends that the Court need not even decide for purposes of these motions, whether the relationships between Plaintiffs and Microsoft were those of "employer-employee" or independent contractors, since the agreements concerning the benefits now sought were clear and unmistakable on the issue of benefits, no matter what label is attached to the Plaintiffs' working status at Microsoft.

Plaintiffs deny that their written agreements with Microsoft (*e.g.* the ICA's), which specifically held them personally responsible for their "benefits," are controlling.[12] They contend that Microsoft's refusal to provide them with employee benefits rests on nothing more than Microsoft's "labelling" them as not entitled to those benefits by calling them "freelancers." They contend that they are entitled to the benefits because in truth they had unilateral contracts, either express or implied, with Microsoft which included the benefits. It is their argument that Microsoft's employee handbooks and manuals, which contain descriptions of the employee benefits given to "regular employees,"[13] constituted a promise of those benefits to *all*

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[12] Plaintiffs make a faint claim that the language in the ICA's and accompanying document was not clear as it related to their ineligibility for employee benefits. Those claims are not persuasive. While some Plaintiffs claim that they did not focus on the "[no] benefits" language, it *is* clear on its face, and no Plaintiff contends that he/she did not understand either upon beginning work as a freelancer or shortly thereafter, that employee benefits were *not* a part of any compensation they would receive from Microsoft.

[13] Microsoft's employee handbooks expressly limit the benefits described therein to "regular employees" and Plaintiffs acknowledge that they knew that they were not "regular employees" or staff. *(see* note 2, *supra.)* The handbooks in question were distributed to regular employees, including

(continued...)

employees in exchange for their working for Microsoft, and that having performed the services of employees, they have met the terms of those unilateral contracts and are entitled to the benefits of "employees."

Central to Plaintiffs' argument is their contention that under Washington state contract law, it is the "work done" by individuals performing services for a company which controls, and not the "label" given the workers by the company.[14] Since, they argue, the undisputed evidence shows that they performed the work of "employees" at Microsoft, they are entitled to the benefits of employees.

They dispose of their concessions that they understood at all relevant times of their freelancer careers with Microsoft that they were *not entitled* to the benefits, by arguing that that previous understanding on their part was based on an inaccurate labeling of them (by Microsoft) as freelancers, when they were actually "employees." In short, their conceded previous understanding that they were not entitled to employee benefits was due to their (allegedly) being misled by Microsoft's mislabelling.[15]

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[13] (...continued)
those Plaintiffs who eventually obtained that status, but were never distributed to Plaintiffs as freelancers. Some of the Plaintiffs never even saw the books on the company premises, and to the extent that any of them saw them, all understood that they did not apply to freelancers.

[14] *E.g.*, Plaintiffs' Brief in Opposition to Microsoft's Motion for Summary Judgment on State Law Claims at 6-7. ("Pl. Br. in Opp.")

[15] Microsoft notes that even assuming *arguendo* that its characterization of Plaintiffs as "independent contractors" was a "misrepresentation" by Microsoft, it was immaterial, since Plaintiffs wanted to work, anyway, and fully understood their status as to benefits. Further, Microsoft contends, even if it constituted a "material misrepresentation," it would have made the ICA's only "voidable" and not "void," and all of the Plaintiffs, with the exception of Vizcaino, continued working at
(continued...)

As the parties concede, no Washington state statute requires an employee to provide the employee benefits in issue. Plaintiffs argue, however, that under Washington case law, an employer may not discriminate between and among groups of its employees as to employee benefits, where the "work done" by all is the same. The cases cited by Plaintiffs for this proposition, however, turn on benefits guaranteed by state *statutes* to certain employees, and do not support the more general proposition for which Plaintiffs cite them.[16] Thus, even if it is conceded that Plaintiffs might satisfy a "common law employee" status test, as found by the IRS for tax purposes, they are not entitled to the benefits sought simply because Microsoft provides those benefits to certain other "regular" employees.

Since the benefits are not required by state law, either statutory or decisional as a result of the "work done," state contract law controls. Microsoft was free to offer or not offer the benefits to Plaintiffs, in exchange for the services performed

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[15] (...continued)
Microsoft after the issue was public.

A misrepresentation is "material" only if the maker knows it would induce a reasonable person to manifest an assent which would otherwise be withheld. *Restatement (Second) of Contracts*, Section 162. All of the evidence presented here clearly indicates that each of the Plaintiffs would have accepted the terms of his/her "freelancer" relationship with Microsoft no matter what 'label' Microsoft gave him/her.

Even Plaintiff Vizcaino, who, ultimately months (if not years), later chose to litigate rather than accept a "temporary employee" designation, acknowledges that she never sought work elsewhere despite the absence of benefits:

Q: Why didn't you apply [sic] work elsewhere?

A: Because I liked what I was doing at Microsoft. (Note 17, *infra*).

[16] *See, e.g.*, Pl. Br. in Opp. at 4-7, and Defendants' Reply Memorandum thereto at 5-7.

by Plaintiffs, and Plaintiffs could accept or reject work under the terms offered. *See Thompson v. St. Regis Paper Co.*, 102 Wn. 2d. 219, 229, 685 P.2d 1081 (1984). Since Plaintiffs plainly entered into a working relationship with Microsoft, the question here remains whether there was an agreement, bilateral or unilateral, express or implied, which entitled Plaintiffs to the benefits.

The bilateral express agreements (the ICA's) between the parties plainly stated that Plaintiffs were responsible for their own "benefits." While some Plaintiffs claim they did not read the agreements carefully, all concede that they knew they were not entitled to benefits. If they did not know it from the first day of their relationship, they knew it very shortly thereafter, and continued working at Microsoft. It may be true, as some Plaintiffs complain, that Microsoft presented the documents on a "take it or leave it" basis, but Microsoft had a right to do so, and Plaintiffs had a right to refuse the terms offered.

Microsoft's argument that the Court need not decide whether Plaintiffs were "independent contractors" is persuasive. Whether they were "independent contractors" or "common law employees," their express working agreements denied them employee benefits.[17]

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[17] Plaintiffs argue that since Plaintiffs Donna Vizcaino and Geoffrey Cuthbert began their work at Microsoft *prior* to the time that Microsoft began requiring freelancers to sign ICA's, that the terms of the ICA, even if otherwise valid as either a unilateral contract or at least an express notice to the signers of Microsoft's intent, cannot be applied to Vizcaino and Cuthbert during the respective periods in their time at Microsoft *before* they signed the ICA's. In the case of Vizcaino, this period was approximately eighteen (18) months; in the case of Cuthbert, it was approximately nineteen months.

While it is true that these Plaintiffs performed services at Microsoft prior to signing ICA's, it is also not contested that both fully understood long

(continued...)

[17] (...continued)
before they signed the ICA's that they were "freelancers" and that that term meant "no benefits." Both conceded as much in their depositions.

Vizcaino testified at her deposition on July 6, 1993, as follows:

Q. You didn't ask anything [during her initial interview] about the benefits on this job?

A. Well, yeah, I must have I guess. I don't remember what we said but, I guess it--yeah, we weren't going to get benefits at that time.

Q. Okay. And just so we understand each other, when you say benefits--let me rephrase the question.
By benefits I assume that you mean, and correct me if I'm wrong, things like holidays, vacation, sick leave, other kinds of paid leave, participation in the employee stock purchase plans, that kind of thing? Is that the way you mean benefits?

A. Yeah.

Q. Okay. Now, at the end of this conversation, this interview with Ms. Carter, I assume it was at the end of the conversation, did you accept the position on the terms that had been discussed in that interview?

A. Yes.

(Deposition of Donna Vizcaino, excerpted in Ex. 1 to Defendants' Memorandum in Support of Motion for Summary Judgment at 39. "Dep. Vizcaino")

****

Q. Why didn't you apply [sic] elsewhere?

A. Because I liked what I was doing at Microsoft.

Q. Did you at any time while you were working at Microsoft see a Microsoft employee handbook?

A. Boy, I don't think so.

(continued...)

[17] (...continued)
(Dep. Vizcaino at 74).

The deposition of Gregory Cuthbert was also taken on July 6, 1993, and is Exhibit 3 to Defendants' Memorandum ("Dep. Cuthbert").

Q. Okay. And you're telling me that that didn't occur [a discussion re benefits] until months after you started working, that any [sic] ever mentioned to you the issue of whether you got benefits?

A. To the best of my recollection, yes.

Q. Okay. Well, let's kind of take it a piece at a time. You started working in July, so after sometime in early September or late August Labor Day came, right? Right?

A. Labor Day does come up in July.

Q. Thank you. And did you get paid for Labor Day?

A. No.

(Dep. Cuthbert, at 42).

****

Q. (By Mr. Oswald) Okay, let's go back to this employee stock purchase plan. When you were hired by Karin Carter, did you she [sic] represent to you that as a freelancer you could participate in the employee stock purchase plan?

A. No, she did not.

(Dep. Cuthbert, at 43).

****

Q. Did you ever hear anybody use the term "regular employee" during you time at Microsoft when you were a freelancer?

A. I do recall, yes.

Q. And when that term was used did you understand it to refer to

(continued...)

[17] (...continued)
people who were salaried as opposed to freelancers?

A. Yes.

Q. So that until this status change [when Cuthbert became a regular employee] in October of 1989 you were never a regular employee at Microsoft?

A. I worked at Microsoft consistently.

Q But you were never what was referred to as a regular employee?

A. That's correct. I was never what was referred to as a regular employee at that time, correct.

Q. And I take it at no time before October of 1989 did you ever apply for benefits of any type from Microsoft: sick leave, vacation, holidays, participation in the employee stock purchase program?

A. I didn't apply for those things.

(Dep. Cuthbert at 46).

****

Q. But during the course of the next few weeks or months [after beginning work at Microsoft] it became clear to you that being a freelancer meant that you got no benefits?

A. That it meant something, if I may, it meant that in some ways I was different from the regular salaried employees with whom I worked.
Q. But among those ways of which it made [sic] you different was that you got no benefits.
A. Correct.

(Dep. Cuthbert at 69).

****

Q. Did you have any understanding at that time [when you became a regular employee of Microsoft] about whether it was common for

(continued...)

Microsoft argues that recognition of the bilateral express agreements ends the issue, since parol evidence is not admissible to show a different agreement, citing *Daniel v. Pacific Northwest Bell Tel. Co.*, 20 Wn. App. 444, 580 P.2d 652, *review denied*, 90 Wn. 2d 1025 (1978). Plaintiffs argue that *Daniel* has been overruled by *Berg v. Hudesman*, 115 Wn. 2d 657, 666-69, 801 P.2d 222 (1990), which held that the parties may "always introduce extrinsic factual evidence, including subsequent conduct of the parties, in interpreting any contract." (Pls, Br. in Opp. at 12).

Plaintiffs' arguments re: the admissibility of parol evidence are persuasive. In this cases, however, the parol evidence offered does not help them on the ultimate question.

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[17] (...continued)

freelancers to be making more on an hourly basis than the equivalent hourly rate for people who were regular salaried employees?

A. Yes.

Q. What was your understanding?

A. That in general freelance production editor on a gross cash basis would stand to make more than a regular staff employee.

(Dep. Cuthbert at 82).

Both Plaintiffs in their sworn testimony thus established that they knew at the point they first began working at Microsoft, or shortly thereafter, that they were not entitled to employee benefits, and both continued to work with that understanding. Even though they might not have signed the ICA's on the first day of work at Microsoft, as did the other Plaintiffs, it is clear that their understanding with Microsoft was that their compensation did not included employee benefits.

All of the declarations and depositions of the *other* named Plaintiffs are *at least* as affirmative in their acknowledgments that they understood they were not entitled to benefits.

Again, it must be repeated that none of the Plaintiffs claim that anyone from Microsoft ever promised them benefits, and all concede that they understood at all material times during their "freelancer" status with Microsoft that they were not entitled to benefits. Knowing these conditions, each Plaintiff chose to begin work and continue work at Microsoft. Plaintiffs offer no parol evidence inconsistent with the terms of the ICA as it relates to the issue of benefits.

Plaintiffs contend that "the real questions here are (1) whether Microsoft's employee benefits programs and plans constitute express or implied unilateral contracts and (2) whether Plaintiffs are entitled to receive those benefits because they qualify under their terms." (Pl. Br. in Opp. at 4). Plaintiffs' "unilateral contract" arguments, however, fail on several points.

Microsoft indeed offered such benefits to its "regular employees" and described them in employee handbooks issued to its regular employees, but *not* to the freelancers. Moreover, it is not contended by any Plaintiff that he/she was ever offered such benefits by any Microsoft spokesperson, or even a handbook, and to the extent that any of them saw the books, they understood that they were *not entitled* to the benefits described therein.

Plaintiffs correctly recognize that the formation of a unilateral contract such as they claim existed, whether express or implied, requires "a promise on the part of the offeror and the performance of the requisite terms by the offeree" (Pl. Brief in Opp. at 2, quoting *Multicare Medical Center v. DSHS*, 114 Wn. 2d 572, 583, 790 P.2d 124 (1990). They cite two Washington cases where unilateral contracts were found as to existing employee benefit plans (offers) which employees had "accepted" by performing work for the employer. *See Scott v. J.F. Dothie & Co.*, 125 Wash. 470, 471-72, 216 P. 853 (1923)

(express unilateral contract), and *Powell v. Republic Creosoting Co.*, 172 Wash. 155, 160-61, 19 P.2d 919 (1933) (implied unilateral contract).

Microsoft correctly points out, however, that while a unilateral contract differs from a bilateral contract as to how it is formed, a unilateral contract *still* is a form of "contract," and requires elements of offer on the one hand, and acceptance by reliance and performance on the other hand. (Def. Reply Memo in Support of Motion for Partial Summary Judgment at 2-5). Microsoft maintains that the undisputed evidence is that *not one* of the elements of a unilateral contract is satisfied here. There was no "offer," since the handbooks in question were never provided to the Plaintiffs, but rather Plaintiffs were expressly told they *would not* receive the benefits, in the ICA documents they signed. Thus, even if the ICA's and supporting documents should fail to constitute bilateral contracts, they would, at a minimum, constitute express notice to Plaintiffs that employee benefits were *not* being offered them.[18] Nor do Plaintiffs maintain that they *relied* upon such an offer in performing such services, since all admit that they *knew* at all material times that they were *not* entitled to the benefits and performed their services *knowing* that they would *not* get the benefits.

---

[18] Another collateral argument as to the ICA's is made by Plaintiffs, who contend that the ICA's at most constitute invalid attempts by Microsoft to obtain "waivers" of employee benefits from them. Plaintiffs contend they are invalid waiver attempts because the documents do not satisfy the requirements of a "waiver" under Washington state law.

Microsoft argues that there is no question of "waiver" present, since it was free under state law to offer Plaintiffs the benefits in issue, or *not* offer them, as it so chose.

Since Microsoft manifestly never offered or intended to offer Plaintiffs the benefits, there was indeed nothing for Plaintiffs to "waive," and Plaintiffs' arguments re: "waiver" are surplusage.

In the face of the undisputed evidence that no offer of benefits was ever made by Microsoft, either express or implied, that no Plaintiff ever relied upon any such offer, and that all Plaintiffs in fact understood at all material times that they did not qualify for employee benefits, Plaintiffs offer the explanation that *Microsoft* really knew all along that they were "regular employee" entitled to benefits, and hid this entitlement from them by "mislabelling" them as independent contractors or freelancers. This argument is not persuasive. "Mislabelling" as used by Plaintiffs implies a unilateral act by Microsoft which in some way hid their true status from Plaintiffs. In truth, Microsoft was quite open about the terms of its working relationships with Plaintiffs on the subject of employee benefits, and each of the Plaintiffs fully understood and accepted those terms. The "label(s)" given the relationship by Microsoft and accepted by Plaintiffs was largely immaterial. Whether Plaintiffs were working under the "independent contractor" label or the "temporary employee" label, each understood "no benefits" and accepted those terms. Plaintiffs thus had unilateral contracts, as claimed, at a minimum, but ones for "no benefits."

Even if one agrees that the nature of their work at Microsoft would satisfy the test(s) for "common law employees," that status would not entitle them to the benefits they now seek. In the absence of a federal or state law mandating award of such benefits to all "common law employees" or "employees," Microsoft was not required to offer them. Here it chose not to offer them, and explicitly notified Plaintiffs that they would not receive them. Plaintiffs chose to work at Microsoft with the understanding of no benefits. Under Washington state law and the undisputed facts of this case, Plaintiffs are unable to establish either a promise by Microsoft to provide the benefit, or justifiable reliance by Plaintiffs upon such a promise, both of which are necessary under Washington law. Whether "bilateral" or "unilateral," a contractual relationship can be

found only by establishing the existence of an agreement between and/or among the parties, either "express" or "implied." Where the facts agreed upon by Plaintiffs not only do not support such a finding, but plainly dictate a conclusion that there was *no agreement*, Plaintiffs can not possibly prevail on this issue. Summary judgment for the defendant is appropriate when plaintiffs cannot prove the existence of an essential element of their case as to which they bear the burden of proof. *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986).[19]

---

[19] In their Brief, Plaintiffs argue that the Court should reform their contracts with Microsoft, in order to provide them the benefits sought. (Plaintiffs' Brief in Support of Partial Summary Judgment on Vacation, Sick Leave, Holidays and Short-Term Disability Leave at 20-23). Reformation, however, is not appropriate to impose upon the parties terms to which there was never an agreement. *Childers v. Alexander*, 18 Wn. App. 706, 710, 571 P.2d 591 (1977), quoting D. Dobbs, *Handbook on the Law of Remedies*, § 11.6, at 747 (1973). Not only was there never an agreement, express or implied, that Microsoft would provide employee benefits to Plaintiffs, but there was, as set out in this Report and Recommendation, an express agreement *not to* provide benefits, and that agreement was well-understood by all concerned.

Plaintiffs argue that they "are not seeking to reform Microsoft's independent agreements to provide for employee benefits," but rather that they "seek to reform them only to show that Plaintiffs were Microsoft employees," after which Plaintiffs could "seek employee benefits under their unilateral contract with Microsoft" (Plaintiffs' Reply Brief on Vacation and Other Paid Leave at 12).

Even if Plaintiffs were successful in having the contracts reformed and thereby "relabelling" themselves as "employees," they would still face the remainder of their express, written agreements with Microsoft that they were responsible for their own benefits. As both Plaintiffs and Defendant argue (even though they end up at different positions), it is not the "label" which is important here, but what the *agreement* controlling the working relationships was.

For all the reasons set out herein, it is my recommendation that the Court find that the clear and unambiguous agreement controlling the working

(continued...)

B. PARTIAL SUMMARY JUDGMENT FOR PLAINTIFFS SHOULD BE ENTERED AS TO THE ISSUE OF PARTICIPATION IN THE ESPP.

Microsoft's Employee Stock Purchase Plan ("ESPP") was created in 1986, and permits employees to purchase stock in the company at 85% of its market value. While the parties do not agree as to the precise monetary value of the ESPP to Plaintiffs, had they been allowed to participate, it is fair to say that the value would be substantial. (According to Defendants, participation could have resulted in doubling the amount of compensation paid to some Plaintiffs for their work as freelancers. Plaintiffs claim that estimate is greatly exaggerated.)

The parties agree that the plain is *not* one of those types of employee stock option plans governed by ERISA, and they also agree that the right to participate in it, like the right to obtain the other employee benefits which is the subject of the instant motions, is governed by state contract law. Plaintiffs contend, however, that interpretation of the terms of the ESPP must be made with reference to the Internal Revenue Code ("IRC"), since Microsoft manifested an intention for the ESPP to comply with that portion of the IRC (Section 423) (hereafter "§ 423") which requires that such programs be open to "all employees." Plaintiffs contend that the uncontested facts establish that they were at least "common law employees" during their period of service as freelancers, that § 423 defines "employees" in terms of "common law employees," and that they were thus eligible to participate in the ESPP.

---

[19] (...continued)
relationship between these Plaintiffs and Microsoft provided for "no benefits." Reformation of that agreement to reach the opposite conclusion is not warranted and is not supported by the uncontested facts in this case.

Microsoft contends that as freelancers Plaintiffs were never entitled to participate in the ESPP, and that they knew that at all times. Microsoft argues further that even if Plaintiffs are found to have been eligible for participation in the ESPP because they were "employees," all of the Plaintiffs failed to take the necessary affirmative step to have deductions taken from their paychecks to purchase the stock, and that they thus have no remedy.

As with the other employee benefits governed by state law, it is uncontested that Plaintiffs signed the above-described ICA and companion papers acknowledging that they were responsible for their "own benefits." As with the other benefits governed by state law, no Plaintiff claims that he/she was ever told by anyone at Microsoft that he/she had a right to participate in the ESPP, and to the extent that any of them knew about the plan or saw any company materials concerning the plan, they did not consider themselves eligible to participate in the ESPP because of their status as freelancers. The uncontested evidence is thus that Microsoft never expressly offered the ESPP benefit to Plaintiffs, and no Plaintiff had any expectation of receiving it as a portion of his/her compensation for any services performed by any Plaintiff as a freelancer on behalf of Microsoft. Rather, all Plaintiffs understood that they would *not* receive the benefit.

Given this admitted clear understanding between Plaintiffs and Microsoft that Plaintiffs would receive *no* employee benefits, the Washington state law of contracts discussed above with respect to the *other* benefits which are the subject of these motions, would normally dictate resolution of the issue of the ESPP benefit in favor of Microsoft. The only question relevant to a determination of Plaintiffs' entitlement to the ESPP benefits which arises with respect to those benefits, but which did not arise as to the other benefits governed by state law, is the effect, if any, of the IRC section cited by Plaintiffs.

While the Court need not decide the true classification *status* of Plaintiffs *vis a vis* Microsoft in order to determine Plaintiffs' entitlement to the *other* "state law benefits" now in issue, that status, i.e., "employee" or "independent contractor," has relevance as to the ESPP. Plaintiffs' rights to the other state law benefits rises or falls solely on their contractual agreement with Microsoft as to those other benefits, no matter what their status. As to the ESPP benefit, however, there is an additional question, due to § 423, and that is whether the existence of § 423, with which Microsoft manifested an express intention to comply, required Microsoft to make the ESPP benefit available to Plaintiffs if they were in fact "common law employees" during their freelancer days with Microsoft? I concluded that it did.

The ESPP states that, in establishing the plan in 1986, the company intended "to have the plan qualify" under § 423, and that its provisions "shall accordingly, be construed to extend . . . participation in a manner consistent with [§ 423]". (Plaintiffs' Brief in Support of Partial Summary Judgment on Eligibility to Participate in Employee Stock Purchase Plan, Appendix N (hereinafter "App. N") at 202208). Microsoft agrees[20] that the original (1986) version of the ESPP made it available to "*any employee of the Company*" (App. N. at 202209), but points out that "any employee" had been changed to "permanent employee" no later than June 1987 (*see*, App. N. at 202204), which in turn was changed to "regular employee" in April, 1989. (*See*, App. N. at 100797).

Plaintiffs acknowledge that § 423 " is intended to provide a tax-advantaged mechanism for making a company's stock available to rank-and-file, not to only management and key

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[20] Defendant's Memorandum in Opposition to Plaintiffs' Motion for Partial Summary Judgment on Eligibility to Participate in Employee Stock Purchase Plan at 17). ("Def. Opp. to Pl. Mot. re: ESPP.")

employees".[21] (Management and key employees stock purchase plans are covered by a different IRC section). Section 423 requires, however, that if the company provides such a plan:

> (4) under the terms of the plan, *options are to be granted to all employees of any corporation whose employees are granted any of such options* by reason of their employment by such corporation, except that there may be excluded—
>
> (A) employees who have been employed less than 2 years,
>
> (B) employees whose customary employment is 20 hours or less per week,
>
> (C) employees whose customary employment is for not more than 5 months in any calendar year, and
>
> (D) highly compensated employees (within the meaning of section 414 (q).

IRC § 423 (b) (4) (emphasis supplied)

Plaintiffs argue that they are clearly "common law employees," that § 423 defines "employee" by resort to the common law definition, and that Microsoft, in its ESPP, chose to exclude only those categories in § 423(b) (4) (B) and (C), neither of which Plaintiffs fall into. Accordingly, they argue, they were entitled to participate in the ESPP, and Microsoft can not bar them on the ground that they never affirmatively applied for participation, where Microsoft incorrectly told them that they were ineligible, and where it is plain that Microsoft would have denied them participation if they *had* applied.

---

[21] Plaintiffs' Opening Brief in Support of Partial Summary Judgment On Eligibility to Participate In Employee Stock Purchase Plan at 6.

Microsoft again argues that resort to the written agreements between it and the respective Plaintiffs should resolve the issue of ESPP benefits in its favor, since the agreements provide for "no benefits" by Microsoft. They argue that § 423 creates no private rights which Plaintiffs may enforce, and that any discrepancy between the categories of individuals included in Microsoft's ESPP, and Microsoft's stated desire to be consistent with § 423 on that point, represents nothing more than a discrepancy in Microsoft's intentions. They also argue that from 1987 on, i.e., during all the years when Plaintiffs were working at Microsoft, the ESPP was expressly limited to first "permanent," and then "regular" employees, and that Plaintiffs clearly were neither. Finally, Microsoft notes that Plaintiffs at all relevant times understood that they were neither, and never worked in reliance upon any expectation that they would be allowed to participate in the ESPP. In short, Microsoft contends that neither § 423 nor Microsoft's intention to create an ESPP meeting § 423's terms, create a right for any of Plaintiffs to participate in the ESPP, and that Microsoft should prevail on the same principals of contract law which dictate a ruling for it on the other "state law employee benefits" discussed in this Report and Recommendation.

Plaintiffs do not contend that § 423, *per se*, provides them with a private right of enforcement. What they *do* contend is that Microsoft expressly incorporated § 423's terms into its ESPP, thereby making an offer to its employees, including its "common law employees," a classification in which they belonged.

Microsoft concedes that the tax qualification requirements of § 423 "permit tax qualification only for plans that extend participation to all common-law-employees." (Def. Opp. Pl. Mot. re: ESPP at 19). And Microsoft expressly indicated in *all* versions of its ESPP plan before the Court, that is intended that:

> The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section [§ 423] of the Code.

App. N. at 100797, 202204, 202208.

This intention is stated in all versions of the ESPP, whether using the terms "any employee," "permanent employee," or "regular employee."

Contrary to Microsoft's current argument, it seems clear that the Company *did* specifically and expressly embrace the terms and conditions of § 423, even though it may not have understood the full implications for coverage purposes, and even though Microsoft apparently had every intention of excluding freelancers form participation in the plan. Microsoft does not really contend at this point that Plaintiffs were not "common law employees," as found by the IRS for tax purposes, and such a contention, were it to be made, would fly in the face of all of the material facts concerning Plaintiffs' work at Microsoft, the existence of which Microsoft acknowledges. Since Microsoft expressly created an ESPP intended to comply with § 423, and in fact expressly embraced the coverage extended by § 423, and since § 423 permits a company to exclude common law employees only by reason of factors not applicable to Plaintiffs, Plaintiffs were entitled to participate in the ESPP.

Microsoft may not prevail by arguing that Plaintiffs did not apply for participation in the ESPP, since it is undisputed that *Microsoft* would not have permitted them to enroll, and incorrectly told them that they were ineligible for enrollment. As Plaintiffs point out, "[i]t is a principle of fundamental justice that if a promisor is himself the cause of the failure of performance, either of an obligation due him or of a condition

upon which his own liability depends, he cannot take advantage of failure." (Plaintiffs' Reply Brief on Stock Purchase Plan at 11, quoting, *James S. Black & Co. v. P & R Co.*, 12 Wn. App. 533, 537, 530 P.2d 722 (1975). Here, Microsoft created a benefit which by its terms was available to Plaintiffs, yet denied them the meaningful opportunity to avail themselves of it. It cannot now defend itself by claiming that they never applied for it.

As a fall-back position, Microsoft urges that even if the Court "remakes" the ESPP to conform to the IRS terms, that the Court should exclude from participation in the plan the following group of employees, whose exclusion is permitted by § 423(b)(4)(A):

"Employees who have been employed less than two years . . . ." While Microsoft states that its ESPP *now* excludes this category of employee, whose exclusion is authorized by § 423, its ESPP did *not* exclude this category during the period when these Plaintiffs were working as freelancers. Microsoft argues that it *could have* excluded "employees who have been employed less than two years" during the period in issue in this case, but did not do so because it "believed freelancers and other short-term workers would be ineligible." (Def. Memo re: ESPP at 21). It claims that it is unreasonable to assume that it intended to include this category of employees and that it should be allowed to exclude them by having the Court reform the ESPP to so reflect. *(Id.)*

Microsoft's argument is not persuasive. Microsoft clearly intended to make the ESPP available to employees with less than two years service, even though § 423 authorized Microsoft to exclude them if it chose to do so. To "reform" the ESPP as Microsoft asks would not only deny these Plaintiffs the ESPP benefit to which I conclude they are entitled, despite Microsoft's intentions to the contrary, but might also jeopardize the ESPP

benefits obtained by other new employees during the time n question. It "is the duty of the Court to declare the meaning of what is written," and not what Microsoft *might have* written. *Wells Trust v. Grand Central Sauna & Hot Tub Co.*, 62 Wn. App. 593, 602, 815 P.2d 284 (1991).

CONCLUSION

For the reasons set forth in this Report and Recommendation, I recommend that the Court:

1) Deny Plaintiffs' Motion for Partial Summary Judgment on Vacation, Sick Leave, Holidays and Short Term Disability Plan;

2) Grant Plaintiffs' Motion for Partial Summary Judgment on Eligibility to Participate in the Employee Stock Purchase Plan;

3) Grant Defendants' Motion for Partial Summary Judgment on Claims Governed by State Law, EXCEPT for that portion of the Motion relating to the Employee Stock Purchase Plan, which should be denied.

DATED: this _____ day of April, 1994.

_____
DAVID E. WILSON
United States Magistrate Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DONNA VIZCAINO; JON R. WAITE; MARK STOUT; GEOFFREY CULBERT; LESLEY STUART; THOMAS MORGAN; ELIZABETH SPOKOINY; LARRY SPOKOINY,	)	No. 94-35770
Plaintiffs-Appellants,	)	D.C. No. CV-93-00178-CRD
v.	)	ORDER
MICROSOFT CORPORATION, and its pension and welfare benefit plans, et al.,	)	
Defendants-Appellees.	)	

Before: HUG, Chief Judge, and BROWNING, FLETCHER, PREGERSON, HALL, O'SCANNLAIN, FERNANDEZ, T.G. NELSON, HAWKINS, TASHIMA, AND THOMAS, Circuit Judges.

Appellants' petition for partial rehearing is DENIED.

Filed: August 26, 1997

Supreme Court, U.S.
FILED
DEC 24 1997
CLERK

No. 97-854

In The

Supreme Court of the United States

October Term, 1997

MICROSOFT CORPORATION, *et al.*,

Petitioners,

vs.

DONNA VIZCAINO, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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QUESTIONS PRESENTED

Petitioner Microsoft asks the Court to review an *en banc* decision of the Ninth Circuit, in which the court re-affirmed a prior panel decision on a claim involving the Employee Stock Purchase Plan (ESPP) governed by Washington state law. The Washington State Department of Labor and Industries, in its *amicus* brief supporting the panel's decision, said the Ninth Circuit's opinion is "consistent with existing law concerning [the] employer-employee relationship," Wash. State Br., p. 1, and it "merely applies recognized law and is breaking no new ground," *id.*, p. 10.

Microsoft asserts the Ninth Circuit "failed even to acknowledge state decisional law that is directly on point," citing (Pet., pp. i, 13), a 1978 decision by division three of the Washington court of appeals, *Daniel v. Pacific Northwest Tel. Co.*, 580 P.2d 652 (Wash. App. 1978). Microsoft fails to mention that it nowhere cited *Daniel* in its Appellees' Brief in the Ninth Circuit. In any event, *Daniel* has been effectively overruled by the Washington Supreme Court. Moreover, Microsoft itself vigorously opposed certification of any issue to the Washington Supreme Court by the Ninth Circuit.

Accordingly, the questions presented are:

1. Is the Ninth Circuit's failure to apply the reasoning of a 1978 intermediate Washington appellate court decision, *Daniel*, to the facts of this case such a far departure from the accepted and usual course of judicial proceedings as to "call for an exercise of this Court's supervisory power," particularly where Microsoft did not even cite *Daniel* in its Appellees' Brief in the Ninth Circuit?

2. Do the following constitute persuasive evidence that the Washington Supreme Court would not apply to the facts of this case the 1978 holding of division three of the Washington court of appeals in *Daniel* that the "independent contractor" label used in the contract was binding in that case?

- The Washington Supreme Court effectively overruled the *Daniel* decision in 1990 when it held that extrinsic evidence, including evidence of surrounding circumstances and of the parties' subsequent conduct, is always admissible to interpret the meaning of a contract;

- Decisions of division three of the Washington court of appeals are not controlling outside of Eastern Washington;

- *Daniel* was inconsistent with general Washington contract law even when it was originally decided; and

- *Daniel* is factually distinguishable.

3. Does anything in the Ninth Circuit panel or *en banc* decision support Microsoft's contention that the Ninth Circuit completely based its decision on "inapplicable federal statutes"?

4. Does any rule, precedent, or policy support Microsoft's request that this Court accept review for the purpose of certifying state law issues to the Washington Supreme Court, particularly where Microsoft vigorously opposed such certification below, even after the Ninth Circuit's panel decision in favor of the plaintiff Workers?

LIST OF PARTIES

Microsoft's Petition identifies the eight named plaintiffs as Respondents. There are also others in a court-certified class, *see* Pet., p. A39 n. 1, most of whom were not identified prior to summary judgment below. The plaintiffs and members of the class are collectively called "the Workers" herein.

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OPINIONS AND ORDERS BELOW

The Ninth Circuit's opinions are reported at 97 F.3d 1187 (9th Cir. 1996) and 120 F.3d 1006 (9th Cir. 1997) (*en banc*) and reprinted in the Petitioner's appendix. The portion of the district court order relating to the ESPP is at pp. A76-A77 of the appendix and the portion of the magistrate judge's report and recommendation relating to the ESPP is at pp. A102-A109 of that appendix.

STATUTES AND REGULATIONS

Microsoft's citation to the Constitution, Art. III, § 2, indicates this is a diversity case. It is not. This case was brought in a Washington state court against Microsoft, a company with its principal place of business in Washington. Microsoft removed it under 28 U.S.C. § 1441(b) because the complaint also included federal ERISA claims. The district court asserted jurisdiction over the Washington contract law claims pursuant to 28 U.S.C. § 1367(a).

The decisions by the Ninth Circuit involved application of Internal Revenue Code § 423 and accompanying Treasury Regulations because Microsoft's Employee Stock Purchase Plan (ESPP) explicitly incorporated these two provisions (ER[1] 83):

> [I]t is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1954. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

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1. "ER" refers to the Excerpt of Record in the Ninth Circuit.

The Treasury Regulations under IRC § 423, incorporated into the ESPP by the provision quoted above, were identified and quoted in part by the Ninth Circuit. 97 F.3d at 1197-98 and n.10, 11 and 13 (Pet., pp. A55-A57).

STATEMENT OF THE CASE

Microsoft's discussion of the facts is replete with errors. The company's discussion of the proceedings below is generally the exact opposite of what actually happened. Microsoft particularly emphasizes its argument that the Ninth Circuit "failed to apply governing state contract law," Pet., p. 2, "disregarding state contract law in favor of inapposite reasoning developed in ERISA cases," *id.*, p. 3, and "[r]elying on an ERISA case from the Eleventh Circuit," *id.*, p. 10. In fact, the precise opposite is true — the two Ninth Circuit opinions in favor of the plaintiff Workers, by the Ninth Circuit panel majority and the *en banc* majority (8-3), relied on many Washington state decisions in deciding the ESPP claim under Washington state contract law. Pet., pp. A11, A16-A17, A54, A58-A59, A61. From the magistrate judge to the *en banc* majority, the opinions below were all in favor of the Workers' ESPP claims, with *one* exception — the district court's order — and *only* that district court decision favoring Microsoft relied exclusively on federal cases, cases that were cited by Microsoft. Pet., pp. A76-A77. Thus, Microsoft's strenuous argument against reliance on federal cases in a decision on the ESPP applies, very strongly, to the *only* decision in its favor.

A. Background

Plaintiffs worked at Microsoft starting in 1987. Some are still working for Microsoft, as are other Workers. Pet., pp. A39-A40. Microsoft misclassified the Workers as "independent contractors" and "temporary agency employees," although they

are employees as defined in the common law. The record shows, and Microsoft concedes, that the Workers were not independent contractors, but in fact employees of Microsoft. Pet., pp. A6, A46 and n.4, A50 and n.9.

The Workers were employed full-time in Microsoft's company offices, under the direction and control of Microsoft supervisors. As software testers, production editors, formatters, and proofreaders, their work is within the core of Microsoft's software business. Pet., p. A3.

> Microsoft fully integrated [the Workers] into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required that they work on-site, they received admittance card keys, office equipment and supplies from the company.

Id. The Workers were not temporary or short-term, working for Microsoft for several years. Pet., pp. A39-A40.

In 1987, Microsoft became concerned that the Workers could be considered employees by the IRS because of their work situation, making it liable for back employment taxes. Pet., p. A3; CR 69, pp. 4102-04. Microsoft identified over 100 full-time in-house "contractors" working on software products who met the common-law standards applied by the IRS for defining an employee. *Id.* In an attempt to avoid a problem with the IRS, Microsoft tried to superficially strengthen its position by making the Workers sign an "Independent Contractor Copyright Assignment and Nondisclosure Agreement" (ICCA). CR 86 at 4; CR 90 at 4. The ICCA focuses on proprietary information and also states that the Worker is an "independent contractor."

ER 67. Notwithstanding these ICCA forms, the IRS found the Workers were employees and it established their employee status for tax purposes. ER 51-52; 70-76. Microsoft agreed to pay employer taxes and issue retroactive W-2 forms to these employees. CR 70 at 4321, 4290-91.

The company converted some Workers into recognized Microsoft employees. CR 70, pp. 7639 *et seq.* For most Workers, Microsoft continued to treat them as "contractors" while making payroll tax deductions. Microsoft arranged with some "payroll service" agencies to issue checks to the Workers using Microsoft funds, from which the agencies make deductions for taxes. ER 99. The "payroll service" agencies had no connection with the employees except check processing and paperwork. ER 99, 129-30; CR 69, p. 203214. Microsoft retained control over every material element of employment — recruitment, training, wages, work assignments, scheduling, supervision, offices, equipment, etc. ER 128-130, 99-100. Thus, the Workers' situation remained the same, except for the company name on their checks. Pet., p. A42.

Workers who were assigned to "payroll service" agencies had to sign new "independent contractor" forms. ER 54, 59-63. These forms stated that the Worker will "perform services for Microsoft Corporation" and identified the Worker's Microsoft supervisor. ER 61, 63. Even though IRS had just determined these Workers were employees of Microsoft, *not* "contractors," the forms continued to say the Worker "is an independent contractor for Microsoft and nothing in this agreement shall be construed as creating an employer-employee relationship." ER 61. After their reclassification as Microsoft employees for tax purposes, plaintiffs submitted claims for benefits. The claims were rejected by Microsoft, which disregarded the facts about their employment and maintained that the employees were "independent contractors" for benefit purposes, even though they were employees for tax purposes. ER 2, 13-15. This case ensued.

B. Magistrate Judge's Report And Recommendations

Summary judgment motions were referred to a magistrate judge, who recommended that the Workers' motion be granted on the ESPP. By its express terms, the ESPP is open to "any employee" who meets certain service requirements. ER 84. Microsoft admitted the Workers are "employees" within the meaning of the ESPP and that they had sufficient service. The magistrate judge explained his recommendation on the ESPP as follows (Pet., pp. A106-A107):

> Plaintiffs do not contend that [IRC] §423, *per se*, provides them with a private right of enforcement. What they *do* contend is that Microsoft expressly incorporated §423's terms into its ESPP, thereby making an offer to its employees, including its "common law employees," a classification in which they belonged.
>
> * * *
>
> Microsoft concedes that the tax qualification requirements of §423 "permit tax qualification only for plans that extend participation to all common-law employees." (Def. Opp. Pl. Mot. re: ESPP at 19). And Microsoft expressly indicated in *all* versions of its ESPP plan before the Court, that it intended that:
>
> > The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section [§423] of the Code.
>
> Microsoft does not really contend at this point that Plaintiffs were not "common law employees,"

> as found by the IRS for tax purposes, and such a contention, were it to be made, would fly in the face of all of the material facts concerning Plaintiffs' work at Microsoft, the existence of which Microsoft acknowledges. Since Microsoft expressly created an ESPP intended to comply with §423, and in fact expressly embraced the coverage extended by §423, and since §423 permits a company to exclude common law employees only by reason of factors not applicable to Plaintiffs, Plaintiffs were entitled to participate in the ESPP.

C. District Court Order

The district court did not accept the magistrate judge's recommendation and it dismissed the Workers' ESPP claim. In deciding the ESPP issues and ruling in favor of Microsoft, the district court relied *only* on federal cases, not citing or discussing a single Washington decision. Pet., pp. A76-A77.

D. The Panel Decision

The Ninth Circuit panel noted, citing *Multicare Medical Ctr. v. DSHS*, 790 P.2d 124, 133 (Wash. 1990), that Washington follows the " 'objective manifestation theory of contracts,' which requires us to 'impute an intention corresponding to the reasonable meaning of a person's words and acts.' " The panel found that

> [t]hrough its incorporation of the tax code provision into the plan, Microsoft manifested an objective intent to make all common-law employees, and hence the plaintiffs, eligible for participation.

Pet., p. A55. The panel emphasized the ESPP itself expressly stated this intention, quoting the ESPP (Pet., p. A55):

> It is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1954. *The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section of the Code.*

(Emphasis by the panel.) The panel explained that IRC § 423, incorporated into the ESPP, requires the company to allow participation in the ESPP by all common-law employees who are not within one of the express statutory exceptions (Pet., p. A55):

> The requirements of §423 dictate that "options are to be granted to all employees of any corporation whose employees are granted any of such options by reasons of their employment by such corporation." 26 U.S.C. §423(b)(4). Because the term "employees" in §423 is construed to refer to "common-law employees," the ESPP, when construed in a manner consistent with the requirements of §423, extends participation to all common-law employees not covered by one of the express exceptions set forth in the plan.

The panel rejected Microsoft's argument that its "independent contractor" forms override the express provisions of the ESPP. The panel found that the pertinent Treasury Regulations for IRC § 423 explicitly make such agreements not controlling. Pet., p. A57. It also noted that interpreting the agreements as disqualifying Workers who are in fact not independent contractors, but are in reality common-law employees, would be inconsistent with the terms of the ESPP, would defeat its stated intent to qualify for favorable tax

treatment, and be contrary to the ESPP's expressly stated rule of construction. Pet., pp. A57-A58.

E. The *En Banc* Decision

The Ninth Circuit adopted the panel decision on the ESPP claim by an 8 to 3 majority, in an opinion by Circuit Judge Fernandez.[2] The *en banc* opinion emphasizes that "[i]t is important to recognize that there is no longer any question that the Workers were employees of Microsoft." Pet., p. A6. The Workers' status is not in question because Microsoft "concede[s] that the Workers were common-law employees. That is to say, they were employees of Microsoft." *Id.* With respect to Microsoft's "contractor" forms, the *en banc* opinion noted that these statements in these forms were in fact not true (Pet., p. A7):

> We now know beyond peradventure that most of this was not, in fact, true because the Workers actually were employees rather than independent contractors. What are we to make of that?

The *en banc* majority elected to construe the agreements as though they were the result of a "simple mistake." Pet., p. A9. Accordingly, the *en banc* opinion explained Microsoft's agreements only apprised the Workers of their responsibilities if they were in fact independent contractors, and did not independently operate to deny them benefits to which they would be entitled if they were employees covered by the plans. Pet., p. A10.

The *en banc* majority noted that, under Washington law, the contract forms would be reformed to reflect the Workers' true status, but this would be unnecessary here (Pet., p. A11):

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2. The *en banc* opinion also remanded an ERISA claim. Neither side seeks review of that portion of the Ninth Circuit's decision.

> But Microsoft saved us and the Workers the trouble of applying reformation doctrine when it agreed that the Workers were, in fact, not independent contractors. Thus, the label became meaningless, as did the explication of what would follow from that label — no withholding, no benefits.

The *en banc* opinion explains that Microsoft agreed in oral argument that this "is not a waiver case" (Pet., p. A12) and thus the Workers had not knowingly and intentionally given up participation in the ESPP under Washington law (*id.*).

Having decided that the mistaken statements in Microsoft forms do not foreclose ESPP participation for the Workers, the *en banc* court addressed the ESPP. The *en banc* majority agreed with the magistrate judge and the panel opinion (Pet., p. A16):

> The ESPP was a plan adopted for the purpose of taking advantage of the benefits conferred under 26 U.S.C. §423. It was approved by the board of directors and by the shareholders of Microsoft. Their action was an offer to employees, as that term is defined in §423. As we have already suggested, we doubt that the corporate officers set out to withdraw the offer from some employees, even if they could have done that. The Workers knew about the fact of that offer, even if they were not aware of its precise terms.

The *en banc* majority rejected Microsoft's arguments, citing several Washington Supreme Court cases holding that, under Washington law, the Workers accept the ESPP offer by their work even if they do not know the precise terms of the ESPP. Pet., p. A16. Thus, the *en banc* majority concluded the Workers are entitled to participate in the ESPP under Washington law. Pet., p. A17.

REASONS FOR DENYING THE WRIT

I.

THE COURT SHOULD DENY CERTIORARI BECAUSE THE NINTH CIRCUIT'S FAILURE TO APPLY TO THE FACTS OF THIS CASE THE REASONING OF A 1978 INTERMEDIATE WASHINGTON STATE APPELLATE COURT DECISION WHICH WAS NOT CITED IN MICROSOFT'S APPELLATE BRIEF IS NOT A DEPARTURE FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS CALLING FOR AN EXERCISE OF THIS COURT'S SUPERVISORY POWER.

Respondent Workers respectfully submit that this case fails to satisfy any of the compelling reasons justifying review by this Court. The sole reason offered by Microsoft is that the Ninth Circuit *en banc* "so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's supervisory power" under S. Ct. Rule 10(a). Pet., pp. 17-18. The only "far departure" alleged by Microsoft is that the Ninth Circuit *en banc* failed to apply to the facts of this case the reasoning by a 1978 intermediate state appellate court decision and that "the court of appeals' decision casts doubt on the enforceability of similar agreements between companies and independent contractors throughout the country." *Id.*

Microsoft cannot possibly claim that the panel that decided this case "departed from the accepted and usual course of judicial proceedings" by failing to follow *Daniel v. Pacific Northwest Tel. Co.*, 580 P.2d 652, *review denied*, 90 Wn.2d 1025 (1978), because Microsoft never even cited *Daniel* in its Brief of Appellees to the Ninth Circuit, arguing it first on appeal only in its petition for rehearing.

Given the judicial resources already devoted to this issue, it is difficult to credit Microsoft's argument that one magistrate judge at the district court level, two judges at the panel level, and eight judges at the *en banc* rehearing, have all so greatly "departed from the accepted and usual course of judicial proceedings." The reality is that this case involves a large company that has a controversial employment practice, not that the majority of judges in the panel and the *en banc* rehearing have run amok, heedless of Washington state precedents.

Microsoft exaggerates the significance of one federal circuit court's interpretation of one contract drafted by one company under the common law of one of the fifty states. This decision binds no one but Microsoft and the Workers. It is not controlling even in Washington courts. *In re Salvini's Estate*, 397 P.2d 811, 813-14 (Wash. 1964). Granting certiorari on a matter of Washington state common law would not in any way increase the significance of this case involving a sing'e contract of a particular employer.

II.

THIS COURT SHOULD DENY CERTIORARI BECAUSE THERE IS PERSUASIVE EVIDENCE THAT THE WASHINGTON SUPREME COURT WOULD NOT APPLY TO THE FACTS OF THIS CASE THE 1978 HOLDING OF DIVISION THREE OF THE WASHINGTON COURT OF APPEALS STATING THAT THE "INDEPENDENT CONTRACTOR" LABEL USED IN THE CONTRACT IN THAT CASE WAS BINDING ON THOSE PARTIES.

A. Prior Cases Decided By A State Intermediate Appellate Court Are Not Binding On The Federal Courts If There Is Persuasive Evidence That The Highest State Court Would Rule Otherwise.

Microsoft's sole ground for certiorari is that the Ninth Circuit allegedly failed to follow the company's interpretation of a decision by division three of Washington's intermediate court of appeals. In 1980, however, the Court eliminated from Rule 10 conflict with applicable state law as a ground for certiorari. Stern, *et al.*, Supreme Court Practice (7th ed. 1993), p. 183. Lacking support in Rule 10, Microsoft relies on cases decided over 50 years ago when this Court was fleshing out the consequences of the doctrine of *Erie RR v. Tompkins*, 304 U.S. 64 (1938). *Fidelity Union Trust Co. v. Field*, 311 U.S. 169 (1940); *West v. A.T. & T.*, 311 U.S. 223 (1940), cited in Pet., pp. i, 15-17. *Fidelity Union* and *West* were apparently reviewed by this Court in order to correct the practice then of circuit courts disagreeing freely with decisions of intermediate state courts of appeals, a practice that undermined the *Erie* doctrine.

Neither *Fidelity Union* nor *West* held that a federal circuit court must slavishly duplicate the holding of an intermediate

state appellate court. To the contrary, *West* expressly held that a rule of law announced by an intermediate state appellate court

> [i]s a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise.

311 U.S. at 237.

This Court later negatively pointed out some of the "persuasive data" that might dissuade a federal court from following an earlier state court decision, describing the lack of such factors in the case before it:

> [T]here appears to be no confusion in the Vermont decisions, no developing line of authorities that casts a shadow over the established ones, no dicta, doubts or ambiguities in the opinions of Vermont judges on the question, no legislative development that promises to undermine the judicial rule.

Bernhardt v. Polygraphic Co., 350 U.S. 198, 205 (1956).

The Court has also observed that the nature and jurisdiction of the intermediate state court is also an important factor to consider, explaining why the Court had held in *Fidelity Union* that the federal circuit court should have followed two four-year-old decisions of the New Jersey Court of Chancery:

> It had state-wide jurisdiction. Its standing on the equity side was comparable to that of New Jersey's intermediate appellate courts on the law side. A uniform ruling by the Court of Chancery over a course of years was seldom set aside by the state's highest court.

King v. Order of United Travelers of America, 333 U.S. 153, 159 (1948).

In the 57 years since *Fidelity Union* and its three companion cases, this Court has rarely found it necessary or appropriate to grant certiorari to simply correct an alleged conflict between a federal circuit court decision and that of an intermediate state court of appeals. Applying to this case the factors described above, certiorari is not appropriate here.[3]

B. Decisions Of Division Three Of The Washington Court Of Appeals Are Not Controlling Even In Washington.

The Court considered the geographic jurisdiction of the state court in considering the weight to be afforded the state court's prior decisions in *King*, *supra*. Washington's intermediate court of appeals is divided into three divisions, each having jurisdiction over certain counties. Rev. Code Wash. 2.06.020. The *Daniel* decision was made by Division Three of the court of appeals, with jurisdiction over only Eastern Washington. Washington Rules of Appellate Procedure 4.1(b). Decisions by one division of the court of appeals do not control the decisions of the other two divisions of the court of appeals, and the divisions periodically disagree expressly with one another's decisions.

3. Microsoft also claims (Pet., p. 14) that this Court should grant review here because "the alternative is allowing blatant federal-court nullification of state law," quoting *Leavitt v. Jane L.*, 116 S. Ct. 2068, 2072 (1996). *Leavitt* had nothing to do with applying an intermediate state court decision on a matter of common law to a private contract dispute. Rather, this Court granted certiorari in *Leavitt* based on a declaration of legislative intent in the statute itself and the impact of invalidating part of the statute under federal constitutional principles. The key factor motivating certiorari in *Leavitt* appears to have been "the total invalidation of a state-wide law" when only part of that statute violated the federal Constitution, *id.*, a concern which is conspicuously absent from this case.

E.g., *Leonard v. Pay'n Save Stores*, 880 P.2d 61, 63-64 (Wash. App. 1994). Even panels of the *same* appellate division disagree with one another. *E.g.*, *State v. Turner*, 665 P.2d 923 (Wash. App. 1983) (division one panel disagreed with different panel of the same division).

This case originated in Western Washington, in King County. Had it not been removed by Microsoft from King County Superior Court to the United States District Court for Western Washington, the *Daniel* case could not have controlled this case anyway (even if it were completely on point).

Finally, unlike decisions of the New Jersey Court of Chancery, which this Court characterized as "seldom set aside by the state's highest court," *King, supra*, 333 U.S. at 159, the Washington Supreme Court reverses over half of the decisions of the Washington courts of appeals accepted for discretionary review.[4]

C. The Washington Supreme Court Effectively Overruled The Daniel Decision When It Held In 1990 That Extrinsic Evidence Is Always Admissible To Interpret A Contract.

In deciding the effect of a prior decision of a state intermediate court, a federal court should consider whether there has been "no developing line of authorities that casts a shadow over the established ones, no dicta, doubts or ambiguities in the opinions of [state court] judges on the question . . ." *Bernhardt, supra*, 350 U.S. at 205. Recent Washington decisions have not just cast a shadow over *Daniel* — they have totally eclipsed it.

Daniel said the plaintiff in that case was bound by the contract recitation that he was an independent contractor and

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4. Wiggins, *What You Should Know Before Seeking Review in the Washington Supreme Court*, 40 Wash. St. Bar News 25 (Feb. 1986).

the plaintiff could not introduce any extrinsic evidence to contradict that factual recitation. 580 P.2d at 653-54. The Washington Supreme Court overruled this premise in 1990, holding that the court can consider all extrinsic evidence and other agreements between the parties, including the "entire circumstances under which the contract was made, as an aid to ascertaining the parties' intent." *Berg v. Hudesman*, 801 P.2d 222, 229 (1990). The Washington Supreme Court held in *Berg* that "subsequent conduct of the parties" and "[a]greements and negotiations prior to or contemporaneous with the adoption of a writing are admissible in evidence to establish. . . . the meaning of the writing, whether or not integrated . . ." 801 P.2d at 229 (quoting, in part, *Restatement (2d) of Contracts* § 214(c)). The Court expressly overruled prior cases to the contrary:

> We thus reject the theory that ambiguity in the meaning of contract language must exist before evidence of the surrounding circumstances is admissible. Cases to the contrary are overruled.

801 P.2d at 230.

The principles in *Berg* were applied to employment contracts in *Swanson v. Liquid Air Corp.*, 826 P.2d 664, 670, 672 (1992). There, the Court held that the nature of an employment contract, and its interpretation, raise questions of fact and, under *Berg*, "extrinsic evidence is admissible as to the entire circumstances" of the employment contract to determine the parties' real intent. *See also Burnside v. Simpson Paper Co.*, 864 P.2d 937, 943-44 (1994). *Daniel's* refusal to allow the plaintiff to raise a question of fact concerning the "independent contractor" designation through submission of extrinsic evidence of the circumstances and the parties' conduct is thus directly contrary to *Berg*.[5]

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5. *Berg's* impact on *Daniel* is shown by *St. Yves v. Mid State Bank*, 757 P.2d 1384 (1988), one of the decisions expressly overruled in *Berg*.

(Cont'd)

Applying *Berg* to the facts of this case, it would have been error to limit the analysis to the ICCA alone. Rather, the ICCA is read together with the ESPP, the ESPP's incorporation of IRC § 423, the circumstances of the Workers' employment at Microsoft, and Microsoft's concession in this case that the Workers are common-law employees. That is exactly what the original Ninth Circuit panel did in its decision, concluding that the Workers are entitled to the benefits of the ESPP. Pet., pp. A54-A61. The eight-judge *en banc* majority similarly read the ICCA together with the ESPP and concluded that the Workers are employees entitled to enjoy the benefits of the ESPP. Pet., pp. A7-A13, A16-A17. To the extent that *Daniel* might have precluded consideration of such extrinsic evidence, *Daniel* was overruled by the Washington Supreme Court in *Berg v. Hudesman*.

D. The Washington Courts Would Not Follow Daniel Because It Is Factually Distinguishable.

Even if *Daniel* were still good law, there is a persuasive reason to conclude that the Washington Supreme Court would not follow *Daniel* because *Daniel* is easily distinguished on its

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(Cont'd)

801 P.2d at 228, 230. In *St. Yves*, an employee claimed he was wrongfully discharged in violation of a personnel manual. *St. Yves* held, reasoning as in *Daniel*, that because the written employment contract unambiguously permitted the discharge, his contract would be enforced exactly as written. The plaintiff in *St. Yves* could not introduce any extrinsic evidence, including the personnel manual, to raise a question of fact concerning his contract rights. *St. Yves*, 757 P.2d at 1386-87. *Berg* cited *St. Yves* as an example of a case mistakenly requiring ambiguity on the face on a written contract before extrinsic evidence will be admitted. *Berg*, 801 P.2d at 228. *Berg* expressly overruled this theory, holding evidence is always admissible without any showing of ambiguity in the contract. 801 P.2d at 230. *Daniel* was effectively overruled by *Berg* for the same reason *St. Yves* was expressly overruled.

facts. In *Daniel*, a dispute actually existed whether the plaintiff was an independent contractor or an employee. 580 P.2d at 653-54. In this case, there is no factual dispute, as the Ninth Circuit noted in its *en banc* decision (Pet., p. A6):

> [B]oth Microsoft and the SPP have conceded for purposes of this appeal that the Workers were common law employees. In fact, they have asserted that the Workers' status is a "nonissue" because they concede that the Workers were common law employees. That is to say, they were employees of Microsoft.

In *Daniel*, the telephone company had no power to control the manner in which Daniel performed his work, it had no power to assign anyone to assist in the work, and it had no power to hire or fire anyone participating in the work. 580 P.2d at 653-54. Daniel hired his own employees, insured his own employees, and controlled his own employees. *Id.* By contrast, in this case the Workers are integrated into Microsoft's workforce, are supervised by Microsoft personnel, may not assign their work to others, and are required to work on-site at Microsoft. Pet., p. A40. *Daniel* itself recognized that such a contract would not be binding where it is the product of "overreaching" by an employer. 580 P.2d at 654.

In short, the contract in *Daniel* mirrored reality; Daniel appeared for all intents and purposes truly to be an independent contractor.

E. *Daniel* Was Inconsistent With Washington Law Even When It Was Originally Decided.

Additional persuasive evidence establishes that the Washington Supreme Court would not follow *Daniel*. *Daniel* is

thoroughly inconsistent with other Washington decisions on the common law of agency and on the effect of contractual recitations of a worker's status as an employee or independent contractor.

Washington follows the general common law of agency. *Hollingberry v. Dunn*, 411 P.2d 431, 435-36 (Wash. 1966); *Rho Co. v. Dept. of Rev.*, 782 P.2d 986, 990-91 (Wash. 1989); *Ebling v. Gove's Cove*, 663 P.2d 132, 134 (Wash. App. 1983). *Daniel's* holding that the plaintiff could not submit extrinsic evidence to disprove his characterization as an "independent contractor" is contrary to the common law of agency, under which the parties' belief that they either are, or are not, creating an employee relationship is only one factor and is not conclusive. *See Hollingberry v. Dunn, supra*, 411 P.2d at 435-36, adopting *Restatement (2d) of Agency* § 220(2)(g), under which the intention of the parties is a factor, but is not dispositive. Whether the worker is actually an employee or an independent contractor depends on whether the worker is subject to the employer's right of control. *Hollingberry*, 411 P.2d at 435-36. Recent Washington Supreme Court cases affirm that Washington follows the general common law in determining "employee" status. *Marquis v. Spokane*, 922 P.2d 43, 50 (Wash. 1996); *DeWater v. State*, 921 P.2d 1059, 1064-65 (Wash. 1996).

In *Rho v. Dep't of Revenue*, 782 P.2d 986, 991 (1989), the Washington Supreme Court explained that the language in a party's contract is not controlling in establishing an agency relationship (*id.*):

> Determination of an agency relationship is not controlled by the manner in which the parties contractually describe their relationship.

* * *

> In this regard, agency is a legal concept that depends on the manifest conduct of the parties; it "does not depend upon the intent of the parties to create it, nor their belief that they have done so. . . . [A]n agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow." Restatement (Second) of Agency §1, comment b (1958), . . . It follows that an agency can be implied, if the facts so warrant, not only if the contracts are silent as to agency, but even if the parties execute contracts expressly disavowing the creation of an agency relationship.

(Citation omitted).

Under the Washington common law of agency, therefore, it is the facts concerning employment that determine employee status, not the words of the contract alone. *Daniel's* statement that the plaintiff could not introduce extrinsic evidence to show that his relationship was not that of an independent contractor, but instead that of an employee, is erroneous under the common law of agency. Thus, under Washington law, Microsoft's forms cannot control if Workers were in fact employees. Microsoft conceded that the Workers were actually its employees (Pet., p. A6), and, thus, the form's boilerplate language to the contrary is immaterial. *Rho, supra,* 782 P.2d at 991; *Restatement (2d) of Agency* § 220(2), discussed in *Hollingberry, supra,* 411 P.2d at 435-36.

Also, under Washington law a contract may be reformed to correct a mutual mistake of either fact or law, as the Ninth Circuit's *en banc* opinion noted, citing *Wilson v. Westinghouse Elec. Corp.*, 530 P.2d 298, 301-02 (1975); *Denny's Restaurants, Inc. v. Security Union Title Ins. Co.*, 859 P.2d 619, 629-30 (1993), and *Scott v. Pettett,* 816 P.2d 1229, 1234-35 (1991). Pet., p. A11.

Accordingly, because the contract would be reformed under Washington law to correct the parties' mutual mistake in describing the employment relationship, *Daniel's* logic could not apply here. The *en banc* opinion said that reformation is unnecessary here only because

> Microsoft saved us and the Workers the trouble of applying the reformation doctrine when it agreed that the Workers were, in fact, not independent contractors. Thus, the label became meaningless, as did the explication of what would follow from the label — no withholding, no benefits.

Pet., p. A11.

Under Washington law, moreover, a statute affecting "construction" of a contract "is incorporated into" and "becomes a part" of the contract. *Dopps v. Alderman,* 121 P.2d 388, 391 (Wash. 1942); *Boggs v. Whitaker,* 784 P.2d 1273, 1274-75 (Wash. App. 1990). Thus, even if the ESPP did not expressly incorporate the eligibility requirements of IRC § 423 and even if the ESPP did not expressly state that "[t]he provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section [423] of the Code," Washington law would nonetheless construe the ESPP in that way. Under the pertinent Treasury Regulations for IRC § 423, any agreement that incorrectly states that the Worker is an independent contractor is "immaterial" and of "no consequence." Treasury Reg. § 31.3401(c)-1(e); Rev. Rul. 87-41, 1987-1 Cum. Bul. 296, 298.[6] Thus, the Ninth Circuit held that the regulation would render Microsoft's "contractor" forms

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6. The Court cited this IRS Revenue Ruling as a source for the general common law of agency when adopting the common-law definition of "employee" for purposes of ERISA in *Nationwide Mut. Ins. Co. v. Darden,* 503 U.S. 318, 324 (1992).

inoperative with respect to participation in the ESPP because Microsoft agreed that the Workers are in fact employees. Pet., p. A57.

Moreover, interpreting the ICCAs as precluding the Workers' participation in the ESPP would cause the plan to lose its tax-qualified status, a status which it is the ESPP's intent to achieve. The Washington Supreme Court recognizes the importance of tax-qualified status of a plan and it said that a plan's tax qualification tends to show the plan is an enforceable unilateral contract, not a discretionary gratuity. *Jacoby v. Grays Harbor Chair & Mfg.*, 468 P.2d 666, 669 (1970). Thus, under Washington law the ESPP is enforceable and the ICCAs do not exclude the Workers from participation in the ESPP where they are in fact employees, as Microsoft concedes they are.

When *Daniel* was decided, it was also well established that a party to a contract "is not bound by a false recital of fact, and parol evidence is admissible to show the true state of affairs." *Cook v. Vennigerholz*, 269 P.2d 824, 827 (1954); *Fed. Finance Co. v. Humiston*, 404 P.2d 465, 467-68 (1965) (written contract recited delivery of consideration which had not been provided); *Black v. Evergreen Land Devel.*, 450 P.2d 470, 476 (1969) (written contract said there were no oral agreements, while evidence showed the parties intended one). Thus, when decided, *Daniel* was mistaken in refusing to permit use of extrinsic evidence to show a written contract is factually wrong (*i.e.*, that he was not an "independent contractor" outside the employer's control, 580 P.2d at 653-54).

In short, *Daniel* was wrongly decided in 1978, is no longer good law after the Washington Supreme Court's *Berg* decision in 1990, is factually distinguishable, and would not control this case even if the case had remained in state court in King County. As the Washington State Department of Labor and Industries

stated, the Ninth Circuit decision is "consistent with existing law" and "merely applies recognized law." Wash. State *Amicus* Br., pp. 1, 10. Microsoft's request that this Court grant certiorari to decide the current vitality of *Daniel,* Pet. p. 18, is thus insupportable.

III.

NEITHER THE PANEL DECISION, NOR THE *EN BANC* NINTH CIRCUIT DECISION, IS BASED ON "INAPPLICABLE FEDERAL STATUTES," AS MICROSOFT CLAIMS.

Microsoft incorrectly alleges in its "questions presented" that the Ninth Circuit erred "by following decisional law under inapplicable federal statutes . . ." Pet., p. i. Microsoft explains that it bases this allegation on the fact that the panel majority, having engaged in a detailed common law contract analysis, also mentioned (in a footnote) that "[a] similar approach obtains with respect to plans that require compliance with the provisions of ERISA." Pet., pp. 8-9, referring to the panel decision at p. A56. Footnotes aside, the panel majority decision is based entirely on Washington state cases, the ESPP's explicit incorporation of IRC § 423, and other states' decisions.[7] Pet., pp. A54-A61.

Microsoft greatly misstates the *en banc* decision when it accuses the majority of "[r]elying on an ERISA case from the Eleventh Circuit . . ." Pet., p. 10. The *en banc* majority held that the "independent contractor" label "was a mere error," citing Washington cases that would support reformation of the ICCA to correct this mistake, but concluding that "Microsoft saved us

7. The panel majority discussed Microsoft's reliance on a Ninth Circuit case, but that case also applied Washington law, not federal law. Pet., pp. A58-A59.

and the Workers the trouble of applying the reformation doctrine when it agreed that the Workers were, in fact, non independent contractors." Pet., p. A11. The *en banc* majority then noted "[a] similar case from the Eleventh Circuit lends support to our conclusion." Pet., p. A11. Citing an ERISA case for additional support after analyzing Washington law does not constitute "following decisional law under inapplicable federal statutes and disregarding state decisional law." Pet., p. i. In any event, this section of the *en banc* opinion (p. A11) explicitly dealt with certain matters that affected claims under *both* federal law (ERISA) and Washington contract law. Pet., pp. A5-A6.

If any doubt remains whether the *en banc* majority applied Washington law, rather than federal law, to the ESPP, that doubt is quickly dispelled by reading the two pages of the *en banc* opinion deciding the ESPP issues. The majority cites only Washington cases, not a single federal case. Pet., pp. A16-A17. In sharp contrast, when the district court accepted *Microsoft's position,* it cited *only federal* cases. Pet., p. A76.

IV.

NO RULE, PRECEDENT, OR POLICY SUPPORTS MICROSOFT'S REMARKABLE PROPOSAL THAT THIS COURT SHOULD GRANT CERTIORARI ONLY TO CERTIFY STATE LAW ISSUES TO THE WASHINGTON SUPREME COURT.

The Court should reject Microsoft's remarkable proposal that this Court should grant certiorari only to vacate the Ninth Circuit's *en banc* decision and remand to certify to the Washington Supreme Court an incomplete and biased question of state law. Microsoft's proposal is all the more cynical because Microsoft vigorously resisted certification while the case was

pending in the Ninth Circuit.[8] Pet., p. 10 n.4. Microsoft's position was that the Ninth Circuit should not certify any issue to the state court unless there was some prospect that Microsoft might lose. *Id.* It is not this Court's responsibility to rescue a litigant from the consequences of its tactical decision.

Microsoft's plea for summary vacation of the Ninth Circuit's *en banc* decision gains no support from *Lehman Brothers v. Schein*, 416 U.S. 386 (1974), cited in the Pet., p. 19. There, the Court remanded to reconsider the possibility of certification, but, as the concurring opinion noted, certification entails both delay and expense and rests within "the considerable discretion of the federal court in going about the decisionmaking process . . ." 416 U.S. at 394-95 (Rehnquist, J., concurring). Moreover, *Lehman Brothers* differs critcally from this case in a key respect — there the party asking this Court to certify to the state court had previously, but unsuccessfully, sought certification in the circuit court, 416 U.S. at 392-93 (Rehnquist, J., concurring), while here the opposite is true.

Nor does Microsoft's position find support in this Court's other cases discussing certification. Pet., p. 19 n.9. Each of those cases challenged the constitutionality of a state statute and this Court held that it would have been preferable if the circuit courts certified the construction of the state statute to the state's highest court to obtain an authoritative construction of the statute, possibly avoiding an unneccessary federal constitutional analysis.

When the Workers suggested the possibility of certification to the Washington Supreme Court if the issues of Washington

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8. The Workers said the Ninth Circuit should certify a question to the Washington Supreme Court if the matter were "unclear" (Appellants' Motion, p. 9) and Microsoft strongly opposed any certification. The Ninth Circuit thus decided the Washington common law issues.

law were "unclear" — after the Ninth Circuit panel decision and prior to the *en banc* decision — Microsoft argued it was too late then to request certification (Opposition, pp. 7-8):

> [C]ertification in late stages of litigation is disfavored for the obvious reason that parties should not be allowed a "second chance at victory" after an adverse decision. *In re McLinn*, 744 F.2d 677, 681 (9th Cir. 1984) ("particularly compelling reasons must be shown when certification is requested for the first time on appeal by a movant who lost on the issue below"); *see Perkins v. Clark Equipment Co.*, 823 F.2d 207, 210 (8th Cir. 1987) (allowing a request for certification in the late stages of litigation may convert the federal court decision into "nothing but a gamble with certification sought only after an adverse decision").

Only now, because the *en banc* Ninth Circuit rejected Microsoft's position again, has Microsoft changed its mind. Its request for certification should be rejected.

Finally, Microsoft argues that this Court should accept review and certify the case to the Washington Supreme Court because the issues in this case are likely to recur frequently, quoting newspaper articles saying the decision could impact employers "across the country." Pet., p. 20. As noted above, the Ninth Circuit's decision does not control even future cases in Washington State, let alone the remaining 49 states. Because such cases are not governed by federal law, it is the responsibility of the state courts to resolve future employer/worker disputes arising under the common law of contracts of the several states.

CONCLUSION

For the reasons stated above, the Court should deny the petition. In the words of the Washington State Department of Labor and Industries, *amicus* below, the Ninth Circuit decision is "consistent with existing law concerning [the] employer-employee relationship," and "merely applies recognized law and is breaking no new ground." Wash. St. Br., pp. 1, 10.

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No. 97-854

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

MICROSOFT CORPORATION, *et al.*,
Petitioners,

v.

DONNA VIZCAINO, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AND THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS AS AMICI CURIAE IN SUPPORT OF THE PETITION

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MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE

Pursuant to Rule 37.2(b) of the Rules of this Court, the Chamber of Commerce of the United States (the "Chamber") and the Association of Private Pension and Welfare Plans (the "APPWP"), (collectively the "Amici") respectfully move this Court for leave to file the accompanying brief as amici curiae in support of the writ for certiorari filed by Petitioners Microsoft Corporation, *et al.* ("Microsoft"). The written consent of Petitioners for the submission of this brief has been filed with the Clerk of the Court. Counsel for Respondents refused to consent to the filing of this brief.

In support of this motion, the Amici show the following:

1. The Chamber is the world's largest business federation representing an underlying membership of more than three million businesses and organizations of every size, sector, and region. Ninety-six percent of the Chamber's

members are businesses with less than 100 employees. The Chamber regularly advocates the interests of its members in courts throughout the country on issues of national concern to the business community. This case is important to the Chamber and all of its members that supply and use freelancers to meet critical business needs.

2. The APPWP is a broad-based, non-profit trade association founded in 1967 to protect and foster the growth of this nation's private employer-sponsored employee benefit plan system. The members of the APPWP include both small and large employer sponsors (including many Fortune 500 companies) of employee benefit plans, as well as numerous plan support organizations, such as consulting and actuarial firms, investment firms, banks, insurers and other professional benefit organizations. Collectively, its more than 240 members sponsor or administer plans covering more than 100 million plan participants. This broad-based membership provides the APPWP with substantial expertise and experience in the entire spectrum of issues relating to all types of benefit plans.

3. Amici have an interest in, and a familiarity with, the issues and policy concerns presented to the Court in this appeal, which transcend the interests of the parties to this case.

4. A significant segment of Amici membership contract regularly with contingent workers, independent contractors, freelancers, and/or temporary employees (collectively "freelancers"), and thus have a great interest in the agreements under which freelancers work. A recent study by the Bureau of Labor Statistics estimated that 5.6 million individuals hold jobs as freelancers in the United States.[1] Other studies estimate that between 1980 and 1993, freelancers made up approximately 25-30% of the United States work force, and that the number of freelancers grew

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[1] Bureau of Labor Statistics, Contingent and Alternative Employment Arrangements, 1 February 1997 (1997).

approximately 40-75% faster than the overall workforce during that period, with 40-55% of the jobs created in that time period consisting of freelance positions.[2] Some estimate that temporary work has grown ten times faster than overall employment since 1982.[3] According to one commentator, "[i]t is expected that [freelancers] will comprise one-half of the labor force by the year 2000.[4]

5. This case raises grave concerns about the ability of businesses to contract with freelancers without embracing unknown and potentially crippling additional costs arising through subsequent litigation. Amici's membership contract with freelancers to supply important skills which businesses cannot replicate without the substantial costs of hiring and training their own employees. Flexible freelance arrangements also allow the Amici membership to provide services in situations where employment costs would be prohibitive. At the same time, working on a temporary or part-time freelance basis brings more workers into the marketplace by allowing them the freedom and flexibility to structure their own lives, and to reap important tax advantages available only to independent businesspeople. Both businesses and freelancers should remain free to create their own mutually acceptable bargains, which may include—as in this case—an agreement to forego employee benefits in exchange for higher compensation. Where knowingly and deliberately arranged, such agreements should be respected and not subject to ex post facto revision through litigation.

6. The issue raised by the Petition—whether individuals who execute written freelance agreements specifically

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[2] Richard S. Belous, *The Rise of the Contingent Work Force: The Key Challenges and Opportunities*, 52 Wash. & Lee L. Rev. 863, 867-868 (1995).

[3] Jonathan P. Hiatt, *Policy Issues Concerning the Contingent Work Force*, 52 Wash. & Lee L. Rev. 739, 741 (1995).

[4] Patricia Schroeder, *Does the Growth in the Contingent Work Force Demand a Change in Federal Policy?*, 52 Wash. & Lee L. Rev. 731, 732 (1995).

acknowledging that they are not entitled to employee benefits subsequently may sue for such benefits by claiming that they are common law employees—is of direct and immediate interest to the Amici and their members. Amici and their members wish to preserve their right to contract with freelancers on mutually advantageous terms, which may include agreements concerning the availability of benefits. The decision below threatens this freedom, and thereby jeopardizes the stability of this large segment of the American workforce.

WHEREFORE, for the reasons stated, the Amici respectfully request that the Court grant it leave to file the accompanying brief as amici curiae.

Respectfully submitted,

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QUESTION PRESENTED

May an individual who executes a written freelance agreement specifically acknowledging that he is not entitled to employee benefits subsequently sue for such benefits by claiming that he is a common law employee?

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BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AND THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS AS AMICI CURIAE IN SUPPORT OF THE PETITION

This Brief is submitted by the Chamber of Commerce of the United States and the Association of Private Pension and Welfare Plans (collectively, the "Amici") as amici curiae in support of Petitioners' request for writ of certiorari.

INTEREST OF AMICI CURIAE [1]

The interest of the amici curiae is fully set forth in the accompanying motion for leave to file this brief.

STATEMENT OF FACTS

Petitioner Microsoft ("Microsoft") established an Employee Stock Purchase Plan ("ESPP") in 1986. Petition Appendix ("Pet. App.") at A42. The ESPP currently provides benefits to Microsoft employees. Pet. App. at A17. The ESPP is a qualified employee stock purchase plan under § 423 of the Internal Revenue Code of 1986 *as amended*, (the "Code").[2] Pet. App. at A5. The ESPP is a contract governed by state law, and is not subject to the Employee Retirement Income Security Act of 1974, *as amended*, ("ERISA") because it does not provide the type of benefits provided by ERISA plans. Pet. App. at A5. *See also* 29 U.S.C. §§ 1002(1) & 1002(2) (listing the types of benefits provided by employee welfare benefit

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[1] No counsel for any party authored any part of this brief, and no person other than amici curiae, their members, or their counsel made any monetary contribution to the preparation or submission of the brief.

[2] According to § 421(a) of the Code, "[i]f a share of stock is transferred to an individual in a transfer in respect of which the requirements of section . . . 423(a) are met [,] no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share . . ." (enumeration omitted).

plans and employee pension benefit plans); Department of Labor Advisory Opinion 90-17A (June 25, 1990) (stating that an employee stock purchase plan is not covered by ERISA).

Each Respondent executed a contract with Microsoft expressly acknowledging that he or she was an independent contractor and agreeing that, as an independent contractor, he or she would "be responsible for all federal and state taxes, withholding, social security, *insurance and other benefits.*" Pet. App. at A27 (emphasis added). Each further agreed that "as an Independent Contractor to Microsoft, you are self-employed and are *responsible to pay all your own insurance and benefits.*" Pet. App. at A27 (emphasis added). Each individual knew and voluntarily accepted the position under the conditions offered, which included higher compensation in lieu of employee benefits. Pet. App. at A64-A67.

Despite these specific agreements, in 1989 the Internal Revenue Service (the "Service") in a tax audit concluded that Respondents should be characterized as employees rather than independent contractors for withholding and employment tax purposes. Pet. App. at A86. The Service did not invalidate the underlying contracts between Respondents and Microsoft, nor did it make any determination regarding Respondents' participation in the ESPP or other employee benefit plans available to Microsoft workers. Pet. App. at A87.

Following the Service's determination, Respondents brought suit, claiming that their status as common law "employees" for withholding and employment tax purposes entitled them to participate in the ESPP regardless of the express terms of their contracts.[3] Pet. App. at A74. The District Court held that each Respondent knew, either at the time he began providing services or shortly there-

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[3] They also claimed eligibility to participate in other Microsoft employee benefit plans, including a 401(k) Savings Plus Plan ("SPP"), which is governed by ERISA. Pet. App. at A2; A5.

after, that he was not entitled to employee benefits but nonetheless continued providing services to Microsoft under the contract. Pet. App. at A74-A75. Accordingly, the District Court determined that as a matter of state contract law, the specific terms of Respondents' contracts controlled, and granted summary judgment to Microsoft. Pet. App. at A73-A77.

A Ninth Circuit panel reversed. Over the dissent of Judge Trott, the panel concluded that because the ESPP was intended as a tax qualified plan under the Code and because the Code requires that qualified employee stock purchase plans offer stock purchase benefits to all common law employees, Respondents were entitled to participate despite their express agreements to the contrary.[4] Pet. App. at A54-A61. Rejecting Microsoft's argument that Respondents were seeking a private right of action to enforce provisions of the Code, the panel concluded that by promulgating an employee stock purchase plan designed to qualify under the Code, Microsoft intended to extend stock purchase benefits to all individuals deemed common law employees regardless of any specific agreements to the contrary. Pet. App. at A54-A61.

A divided court affirmed *en banc*.[5] The majority again concluded that Respondents were eligible for stock purchase benefits because the plan was designed to comply with the Code, and because § 423 of the Code requires that all employees be allowed to participate in employee

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[4] The panel further found that Respondents were entitled to participate in the SPP under ERISA because they were "on the United States payroll of the employer", even though they were paid as independent contractors and not payroll employees throughout their tenure. Pet. App. at A45-A54.

[5] The *en banc* majority remanded Respondents' eligibility for benefits under the ERISA-governed SPP to the plan administrator for consideration, although concluding that the plan administrator's apparent reason for denying benefits to Respondents (that Respondents waived the benefits) was "arbitrary and capricious" as a matter of law. Pet. App. at A13-A16.

stock purchase plans as a condition of receiving favorable tax treatment. Pet. App. at A16-A17. The majority held that the express contracts between Respondents and Microsoft were not controlling, but instead constituted mere "helpful disclosure[s]". Pet. App. at A9. Instead, the majority concluded that the ESPP itself constituted a binding offer of a contract for stock purchase benefits under state law extended to all common law employees of Microsoft, and that Respondents accepted this offer by working for Microsoft, albeit pursuant to individual contracts which specifically negated any eligibility for employee benefits. Pet. App. at A16-A17. Three circuit judges dissented, relying upon state contract law precedent premised upon the actual rather than the legally presumed intentions of the parties. Pet. App. at A25-A36.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CREATES A FEDERAL RULE OF LAW WHICH THREATENS THE STABILITY OF THE WORKPLACE AND GRANTS A PRIVATE RIGHT OF ACTION TO ENFORCE THE INTERNAL REVENUE CODE.

A. The Decision Below Creates a Federal Rule of Law Which Threatens the Stability of the Workplace.

The decision below, while purporting to interpret state law, in fact creates a uniform federal common law rule that every employee stock purchase plan which seeks to qualify under the Code (which includes every such plan)[6] must be construed to extend benefits to every common law employee, and that specific agreements to the contrary are unavailing and unenforceable as a matter of

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[6] Stock purchase plans normally are qualified under the Code to defer taxation of income to employees. Employers, may, however, establish non-qualified stock purchase programs for their employees, in which case the employee's receipt of employer stock is a taxable event.

law.[7] That rule creates grave risks to essential attributes of freedom of contract which govern the burgeoning freelancer workforce throughout the United States. The Ninth Circuit's rule will also engender broad-scale class litigation on behalf of workers who accepted the benefits of freelance status but seek to revise their bargain through subsequent litigation.

The Court long has understood the primacy of freedom of contract, noting that the contract clause in the Constitution embodies

> the high value the Framers placed on the protection of private contracts. Contracts enable private individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 245 (1978). Indeed, "[m]arket efficiency requires effective means to enforce private agreements." *American Airlines, Inc. v. Wolens*, 115 S. Ct. 817, 824 (1995).

Yet the decision below not only ignores express private agreements regarding the availability of employee benefits, but finds those agreements insufficient as a matter of law to overcome a legal presumption (based upon federal tax laws) that every employee stock purchase plan which seeks tax qualified status necessarily intends to extend benefits to every person found to be a common law employee. If the Ninth Circuit is correct, the availability of employee benefits will always be governed by whether an individual is a common law employee, and the stability and predictability afforded by private contracts specifically

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[7] The *en banc* majority did not specifically endorse such a blanket rule for ERISA plans, although it did state that a decision denying benefits to common law employees under such plans on the grounds that the individuals waived the benefits was arbitrary and capricious as a matter of law. Pet. App. at A13.

defining whether an individual is entitled to benefits must be disregarded.

Basing benefit eligibility solely and exclusively upon common law employee status without regard to specific private agreements places businesses at serious risk of dramatically enhanced costs and broad-scale benefit litigation. The Court has noted many times that the distinction between an independent contractor and a common law employee is imprecise at best:

> [T]here is no shorthand formula or magic phrase that can be applied to find the answer, but all of the incidents of the relationship must be assessed and weighed with no one factor being decisive. What is important is that the total factual context is assessed in light of the pertinent common-law agency principles.

NLRB v. United Ins. Co. of Am., 390 U.S. 254, 258 (1968).[8]

A rule which places businesses at multi-million dollar class action risk from misclassification of independent contractors under the common law agency test has nothing to recommend it. Indeed, such a rule sacrifices the stability and predictability essential for American business, which is constantly faced with decisions about staffing and workforce development which involve, *inter alia*, comparative costs for employees and independent contractors. Businesses which decide to have particular tasks performed by individuals who freely agree they are engaged as inde-

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[8] The complexity of this inquiry was described by the General Accounting Office as follows:

> [M]any employers struggle in making the [employee/independent contractor] classification decision because of the unclear rules. Until the classification rules are clarified, we are not optimistic that the confusion over who is an independent contractor and who is an employee can be avoided.

Pet. App. at A67-68 & n.1; *and see* James E. Merritt, *Understanding and Mitigating the Consequences of Reclassification of Workers from Independent Contractors to Employees*, 43 Major Tax Planning ¶ 1200 *et seq.* (1991).

pendent contractors and reap the benefits thereof [9] should not be placed at huge financial risk through subsequent litigation based upon the inherently unclear common law distinction between independent contractors and employees. Absent action by the Court, these risks are certain to grow dramatically as the number of freelance workers continues to increase and more lawsuits like this one are brought.

B. The Decision Below Grants Respondents a Private Right of Action to Enforce the Provisions of the Internal Revenue Code.

Not only does the decision below threaten to disrupt the workplace; it is legally flawed because it grants Respondents an unprecedented private right of action to enforce provisions of the Code. The majority below reasoned that Respondents were entitled to prevail in their suit for benefits because the ESPP was designed to qualify for the tax advantages provided by the Code. Yet behind the majority's facade of contractual intent under state law lies the proposition that a stated desire to comply with the federal tax laws necessarily means that individuals who would benefit from a particular construction may enforce compliance with those laws through lawsuits such as this.

That does not follow as a matter of logic, and certainly does not follow as a matter of law. Logically, Microsoft may have jeopardized the tax qualified status of its plan by its specific agreements with Respondents. If so, it is responsible for the consequences. But its clear decision to do so, manifested by its specific agreements with Respondents, cannot be set aside by Respondents in this lawsuit designed to compel compliance with the tax laws.

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[9] As independent contractors, Respondents paid federal and state taxes on a far more favorable basis than employees, and were able to take deductions for contributions to Individual Retirement Accounts ("IRAs") and business expenses such as travel, meals, entertainment, welfare benefits and depreciation of equipment used in their business without regard to the two percent floor on deduction of business expenses applicable to employees.

The Court repeatedly has noted that "the fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person." *Cannon v. University of Chicago,* 441 U.S. 677, 688 (1979).

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Cort v. Ash, 422 U.S. 66, 78 (1975) (citations omitted). The Court refined the *Cort* test in *Touche Ross & Co. v. Redington,* 442 U.S. 560 (1979):

> It is true that in *Cort v. Ash,* the Court set forth four factors that it considered "relevant" in determining whether a private remedy is implicit in a statute not expressly providing one. But the Court did not decide that each of these factors is entitled to equal weight. The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action.

Id. at 575.

No court, aside from the Ninth Circuit below, has held that the tax qualification provisions of the Code create a private right of action.[10] It is hornbook law that "[t]he

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[10] *Reklau v. Merchants Nat'l Corp.,* 808 F.2d 628, 631 (7th Cir. 1986) ("[w]e hold that the district court's refusal to find an implied cause of action under § 401 of the I.R.C. was proper"); *Cowan v.*

provisions of I.R.C. § 401(a) relate solely to the criteria for tax qualification under the Internal Revenue Code . . . I.R.C. § 401(a) does not appear to create any substantive rights that a beneficiary or participant of a qualified retirement trust can enforce." *In re Witwer*, 148 B.R. 930, 937 (C.D. Cal. 1992) *aff'd without opinion*, 163 B.R. 614 (9th Cir. 1994).[11] Microsoft may have misclassified Respondents and jeopardized the tax qualification of its ESPP. It does not follow that Microsoft's intention that Respondents *not* participate in the ESPP, and the correlative clear written intention of Respondents based upon their contracts, should be set aside.

While Respondents (and the majority below) admit that they cannot enforce the Code, they contend that "they can enforce the ESPP, which expressly incorporates the requirements of [Code] § 423." Appellants Opening Brief at 14.[12] This claim, and the majority's conclusion

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Keystone Employee Profit Sharing Fund, 586 F.2d 888, 890 n.3 (1st Cir. 1978) ("Cowan has also argued that he has a cause of action under I.R.C. § 401. He has not spelled out any plausible theory supporting this position, however, and we can think of none. This section does not appear to create any substantive rights that a beneficiary of a qualified retirement trust can enforce"); *Wiesner v. Romo Paper Prods. Corp. Employees' Retirement Plan*, 514 F. Supp. 289, 291 n.2 (E.D.N.Y. 1981) ("[t]here is no merit in plaintiff's repeated arguments that federal jurisdiction is available because the defendants' conduct assertedly entails violations of Internal Revenue Code provisions governing pension plans. The sections relied on . . . do not create a substantive right that a beneficiary, participant or fiduciary could enforce"); *Barlow v. Marriott Corp.*, 328 F. Supp. 624, 631 (D. Md. 1971) ("[i]n sum, the Congress created neither explicitly nor implicitly any right in any employee under section 401(a)(4)"); *see also Salazar v. Brown*, 940 F. Supp. 160, 166 (W.D. Mich. 1996) ("the Sixth Circuit would clearly find it persuasive that Congress has passed thousands of amendments to . . . the Internal Revenue Code, virtually on a yearly basis, without once creating a private right of action").

[11] Code § 401(a) sets forth the requirements for qualified pension, profit-sharing and stock bonus plans.

[12] A copy of Appellants' Opening Brief as filed in the Ninth Circuit has been lodged with the Clerk's office.

on this point, simply overlooks the practical effect of Respondents' claim. Despite their careful word-smithing, Respondents *are* seeking to force Microsoft to comply with the tax qualification provisions of the Code by suggesting that the ESPP should be construed to include them because inclusion would "effectuate[] the plan's intent to be tax-qualified and avoid[] adverse tax consequences." Appellants' Opening Brief at 15. "Effectuating" the plan's intentions in this way, however, is nothing more than allowing individuals to enforce the federal tax laws under the guise of state contract law. The Court should grant the writ to reverse this transparent effort.

CONCLUSION

For all the foregoing reasons, Amici respectfully request that the Court grant the petition for writ of certiorari.

Respectfully submitted,

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MICROSOFT CORPORATION, *et al.*,
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v.
DONNA VIZCAINO, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF *AMICI CURIAE* OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, AMERICAN ELECTRONICS ASSOCIATION, AND SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF THE PETITION OF MICROSOFT CORPORATION

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MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

Information Technology Association of America ("ITAA"), American Electronics Association ("AEA") and Software Publishers Association ("SPA") (collectively the "Employer Amici") respectfully move this Court, pursuant to Supreme Court Rule 37, to grant leave to file their brief, submitted herewith, as *Amici Curiae* in Support of the Petition for Writ of Certiorari filed by Microsoft Corporation ("Microsoft").

Pursuant to Supreme Court Rule 37.2, the Employer Amici have obtained the consent of Petitioner Microsoft Corporation to the filing of their Brief *Amici Curiae*. However, Stephen Strong, counsel for Respondents Donna Vizcaino, Jon R. Waite, Mark Stout, Geoffrey Culbert, Lesley Stuart, Thomas Morgan, Elizabeth Spokoiny and Larry Spokoiny, declined to consent to the filing of this Brief.

The Employer Amici are the leading trade associations in the information technology ("IT") and electronics industries. Information Technology Association of America ("ITAA") is a leading trade association of companies that create and market products and services associated with computers, communications and data. ITAA's 11,000 direct and affiliate members encompass systems integration, professional services, telecommunications, Internet, electronic commerce, client-servers and custom software manufacturing. IT products constitute the United States' number one export and the industry has a current workforce total of over 2.5 million individuals.

American Electronics Association ("AEA") members, which number over 3,000, are companies that conduct business in virtually every aspect of technology, including the fields of computer software and hardware, components, peripherals, semi-conductors and telecommunications. AEA estimates that 4.3 million people work in the industries it represents.

Software Publishers Association ("SPA") is the principal trade association of the personal computer software industry. Its membership of more than 1,200 companies represents 90% of all software publishers in the United States. SPA members sold more than $30 billion of software in 1995.

This case is of exceptional importance to the industries represented by the Employer Amici. Much of the work in the IT and electronics industries is project-oriented, demanding mobile, highly educated and highly compensated workers on a flexible, temporary or infreqent basis. Industry employers have met these demands by engaging workers in varying contractual relationships, including as independent contractors, temporary "contract" employees and leased employees.

In entering into relationships with skilled workers, members of the Employer Amici, like their counterparts in other industries, frequently enter into written contracts

governing pay and benefits. When the parties intend that the worker will not receive benefits as an employee, the contract will say so. Typically, these contracts also attempt to clarify the parties' respective employment tax and withholding obligations, so that the worker and the recipient of the services will treat the transaction consistently for tax purposes. That is exactly what Microsoft did, and it is very common practice throughout the IT and electronics industries.

The Ninth Circuit's holding in *Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997), upsets the legitimate, settled contractual rights of businesses throughout all industries, and it does so retroactively. The IT and electronics industries are particularly at risk from the fallout of *Vizcaino*, because of their extensive use of highly skilled alternative workers, such as computer programmers, product testers and systems analysts, to work on specific projects and to provide specialized technological expertise. Further, the industries' common use of equity compensation to reward employees provides disgruntled workers with a windfall if they are able, at their discretion, to reconsider and repudiate the independent contractor characterization to which they themselves agreed.

Because of their role as leading trade associations in the eletctronics and IT industries, the Employer Amici have an understanding of the impact the *Vizcaino* decision will have on these industries nation-wide. The Employer Amici's Brief explains the critical role that alternative workers play in the IT and electronics industries and the United States as a whole, as well as the important reasons businesses and workers enter into alternative arrangements.

The Brief *Amici Curiae* also discusses the serious difficulty and uncertainty that businesses face when they classify highly skilled workers as employers or independent contractors and the extraordinary, retroactive burden that the ruling places on nearly every employer who misclassi-

fies workers. It also addresses the use of employee stock purchase plans in high technology industries. The Employer Amici believe that their Brief will serve to impress upon the Court the importance of this case to United States employers and the critical need for this Court to grant Microsoft's Petition for Writ of Certiorari.

This motion is timely filed pursuant to Supreme Court Rule 37.2.

For the foregoing reasons, the Employer Amici respectfully request that the Court grant them leave to file their Brief *Amici Curiae* in support of Microsoft's Petition for Writ of Certiorari.

Respectfully submitted,

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BRIEF *AMICI CURIAE* OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, AMERICAN ELECTRONICS ASSOCIATION, AND SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF THE PETITION OF MICROSOFT CORPORATION

INTEREST OF THE *AMICI CURIAE*

Information Technology Association of America ("ITAA"), American Electronics Association ("AEA") and Software Publishers Association ("SPA") (collectively the "Employer Amici") respectfully submit this Brief *Amici Curiae*[1] in support of the Petition for Writ of Certiorari filed by Microsoft Corporation ("Microsoft").

ITAA is a leading trade association of the companies which create and market products and services associated

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[1] This brief was authored in whole by counsel for the Employer Amici, Seyfarth, Shaw, Fairweather & Geraldson.

with computers, communications and data. ITAA's 11,000 direct and affiliate members encompass systems integration, professional services, telecommunications, Internet, electronic commerce, client-servers and custom software manufacturing. The information technology ("IT") industry's workforce currently totals over 2.5 million individuals, ten times that of the basic steel industry, and three times that of the automotive industry. IT is our country's number one export.

AEA is a leading trade association of the electronics and IT industries, with over 3,000 members. AEA members include companies doing business in virtually every aspect of technology, including the fields of computer software and hardware, components, peripherals, semiconductors and telecommunications. Its members range in size from large, well-known corporations to small start-up ventures. AEA estimates that 4.3 million people work in the industries it represents.

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This case is of exceptional importance to the industries represented by the Employer Amici. The IT and electronics industries are growing at a very rapid pace and in some areas production demand outstrips the supply of available workers. Much of the work is project-oriented, demanding mobile, highly educated and highly compensated workers on a flexible, temporary or infrequent basis. Industry employers have met these demands by engaging workers in varying contractual relationships, including as independent contractors, temporary "contract" employees and leased employees.

In entering into relationships with skilled workers, members of the Employer Amici, like their counterparts in other industries, frequently enter into written contracts governing pay and benefits. If the parties intend that the worker will not receive benefits as an employee, the contract will say so. Typically, these contracts also clarify the parties' respective employment tax and withholding obligations, so that the worker and the recipient of the services (and the leasing company, if there is one) will treat the transaction consistently for tax purposes. That is exactly what Microsoft did, and it is very common practice throughout the IT and electronics industries. Reclassification of a worker, however, must not change the basic terms of their contract—what services the worker will provide and what he or she will be paid.

The Ninth Circuit's holding in *Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997), upsets the legitimate, settled contractual rights of businesses throughout all industries, and it does so retroactively. The IT and electronics industries are particularly at risk from the fallout of *Vizcaino,* because of their extensive use of highly skilled alternative workers, such as computer programmers, product testers and systems analysts, to work on specific projects and to provide specialized technological expertise. Further, the industries' common use of equity compensation to reward employees provides disgruntled workers a financial brass ring to aim for in second-guessing the independent contractor characterization that they themselves agreed to.

SUMMARY OF ARGUMENTS

This case is important because the non-traditional workforce is a large and important segment of the United States economy. Independent contractors, temporary help agency workers and other "alternative workers" comprise 10% of the nation's workforce.[2] Independent contractors

[2] The phrase "alternative work" refers to work outside of the traditional employer-employee relationship. It encompasses inde-

alone comprise 6.7% of the workforce. The determination of whether a worker is an employee or an indpendent contractor—or whether a temporary help agency worker is an employee of the agency or the service recipient—is necessarily a factual determination, and the right answer is often a very difficult and uncertain one. Where the employer and worker have selected the wrong characterization for tax purposes, they may face significant adverse consequences, including liability for back taxes, penalties and interest.

Vizcaino v. Microsoft Corp. imposes an additional, draconian penalty on employers who have misclassified workers, in the form of a retroactive award of benefits. In the guise of applying state law, the Ninth Circuit has created a doctrine of Federal common law that is openly hostile to non-traditional work arrangements. The doctrine is simple: An employer who has misclassified a worker as an independent contractor may be required to provide employee benefits to the worker *retroactively*, notwithstanding that the worker has agreed to the classification and has further agreed not to receive such benefits.

This doctrine has no basis in Federal law and is inimical to the approach to worker classification issues taken by Congress and the Internal Revenue Service ("IRS"). It will discourage employers from voluntarily correcting worker misclassifications, as Microsoft did, because doing so will be used as a club against them in subsequent litigation. It may also chill the development and use of alternative work arrangements going forward. Such non-

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pendent contractors (regardless of whether they are otherwise identified as wage and salary workers), on-call workers, temporary help agency workers and workers provided by contract firms. The figures cited in the text are from the Bureau of Labor Statistics, U.S. Dep't of Labor, news release, U.S.D.L. 97-422, *Contingent and Alternative Employment Arrangements, February 1997, Labor Force Statistics from the Current Population Survey* (Dec. 2, 1997) (cited as "BLS"). The definitions used in the text follow the BLS definitions.

traditional work arrangements are, however, vital to American industry and beneficial to the workers who enter into them.

It is undisputed that any rights Microsoft's "freelancers" could have to participate in the corporation's Employee Stock Purchase Plan ("ESPP") must be found under contract law of the State of Washington. Yet the court's analysis utterly tramples the essential elements of Washington law governing contract formation and reformation. In disregarding the parties' expressed intent, the Ninth Circuit assigns to Microsoft an intent that ignores the fundamental purpose of equity compensation and unjustly enriches the freelancers who neither bargained for nor expected to receive ESPP benefits. In essence, the court has created a new private cause of action to enforce the tax provision relating to stock purchase plans, Section 423 of the Internal Revenue Code of 1986 ("Code"), 26 U.S.C.A. § 423 (1988), in violation of the principles espoused by this Court in *Cort v. Ash*, 422 U.S. 66 (1975).

Vizcaino v. Microsoft Corp. raises the question of whether a Federal court may ignore state law to impose a retroactive obligation on an employer to provide a benefit to a party, in the absence of a Federal law requirng such benefit to be provided, and in the face of a contract stating that such benefit will not be provided. The Ninth Circuit's decision imposes an enormous cost on businesses throughout the country that have made good faith efforts to comply with the complex and changing rules regarding worker classification. Unless the decision is reviewed and reversed, these businesses will face a flood of litigation, in which workers will challenge the independent contractor status that they themselves agreed to, in order to gain windfall benefits.

ARGUMENT

I. THE NINTH CIRCUIT OPINION UNDERMINES ALTERNATIVE WORK ARRANGEMENTS THAT BENEFIT BOTH BUSINESSES AND WORKERS.

Underlying the Ninth Circuit's opinion in *Vizcaino v. Microsoft Corp.* is a steadfast refusal to view the independent contractor agreements ("ICAs") entered into between Microsoft and the freelancers as truly bilateral agreements freely entered into by the parties. Instead, the court makes Microsoft solely responsible for classification of the freelancers as independent contractors. By doing so, the court converts an agreement and accompanying information sheet, each signed by the freelancer, each acknowledging that he or she is an independent contractor and is not entitled to benefits, into non-agreement "explanations" not binding upon the freelancers. *Vizcaino,* 120 F.3d at 1019.

The court's presumption appears to be based on a view of alternative workers as displaced clerical workers who work for low pay and no benefits and are forced to move from office to office on a daily basis. This caricature of the alternative work force is certainly not true of the freelancers at Microsoft; nor is it true in the United States work force as a whole. Microsoft's freelancers were apparently well-educated—performing services as software testers, production editors, proof readers, formatters and indexers—and often worked for periods exceeding two years. 120 F.3d at 1008.

About 10% of the American work force—over 12.5 million people—are actively employed in alternative work arrangements, mostly as independent contractors. BLS, Table A.[3] Independent contractors are significantly more

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[3] The BLS includes as independent contractors persons identified as independent contractors, consultants and freelance workers, but excludes business owners such as shopkeepers and restauranteurs. BLS, Technical Notes.

likely than traditional employees to have graduated college and are more likely to be employed in managerial, sales, professional specialty or precision production occupations. BLS, Tables 4 & 8. Fewer than one-half of alternative workers are in contingent or temporary jobs expected to be of limited duration. BLS, Table A.

Most telling, however, is that the overwhelming majority of independent contractors, 83.6%, actually prefer an alternative work arrangement over a more traditional employment arrangement. BLS, Table 11.

Businesses and workers enter into non-traditional work arrangements for a number of very important reasons. Many businesses rely on temporary or contingent workers to meet short-term or cyclical production demands:

> Accommodating an uneven demand for the organization's products or services may entail a variety of costs, including costs associated with carrying more workers on the payroll than are needed during slow periods and/or costs associated with varying the size of the regular workforce. Some firms may be able to smooth the flow of in-house work by contracting out peak period tasks.

Katherine Abraham & Susan Taylor, *Firms' Use of Outside Contractors: Theory and Evidence,* 14 J. of Lab. Econ. 394, 397 (1996). This is particularly true in the IT and software industries, where businesses may need to "staff-up" rapidly as a specific project or program moves into production.

In IT and other high-technology industries, where the demand for certain skills outpaces supply, non-traditional work arrangements are particularly important:

> Volatility of information technology has the effect of rapidly making IS [information services] skills obsolete and creating IS skills shortages. Firms may outsource because they cannot find and recruit sufficient numbers of permanent employees with certain skills. Outsourcing can help address labor shortages be-

> cause temporary help agencies, part time work, and contract work may attract people into the labor pool who would not enter if they had to work as permanent employees.

Sandra Slaughter & Ang Sun, *Employment Outsourcing in Information Systems,* 39 Ass'n for Computing Machinery 47 (July 1996).

Many businesses turn to alternative work arrangements because they do not have the technical expertise to hire, train or supervise workers with highly specialized skills. Where a business does not have sufficient need for a worker's highly specialized skills to keep the worker fully employed, both parties may prefer a non-traditional employment arrangement:

> For example, it may not be cost-effective for a small- or medium-sized organization to provide a full range of computer support activities in-house. Even if the firm could keep one or more full-time computer specialists busy, much of the day-to-day work likely would be rather routine. More complex problems would be outside the experience of the in-house staff. . . .

Abraham & Taylor, 14 Journal of Labor Economics at 399. *See also* Lewis Segal and Daniel Sullivan. *The Growth of Temporary Services Work,* Federal Reserve Bank of Chicago Working Paper Series, WP-96-26 (Dec. 1996).

An alternative work arrangement may also be extremely attractive from the worker's perspective. An independent contractor typically receives more of his or her compensation in cash than a traditional worker, BLS, Table 13, and will presumably make more efficient choices about his or her benefits than an employer would. Non-traditional workers may prefer the flexibility and control they exercise over their time and working conditions. For highly skilled workers, in particular, an alternative work arrange-

ment may provide a significantly better opportunity for professional development and exposure to a wider range of challenges than a traditional employment relationship.

Thus, the use of non-traditional work arrangements is driven by the needs of both businesses *and* their workers, and the contracts entered into between businesses and their alternative workers benefit both. The Ninth Circuit's opinion in *Vizcaino v. Microsoft Corp.* undermines these contracts by allocating the entire risk of worker mischaracterization to only one party, the employer, and by granting a windfall benefit to workers retroactively.

II. THE NINTH CIRCUIT OPINION IMPOSES A DRACONIAN PENALTY ON EMPLOYERS FOR WORKER MISCLASSICATION.

In effect, the Ninth Circuit's opinion imposes a retroactive, judicial sanction on Microsoft for misclassifying the freelancers as independent contractors for tax purposes that is without precedent in Federal statute or common law. This result ignores the real-world difficulties surrounding the proper characterization of workers in the marketplace. In its internal training manual, the IRS makes this point:

> [IRS] representatives are sometimes faced with the difficult task of making a determination of the classification of workers who provide products and services for others. . . . Businesses decide whether to hire independent contractors or employees depending on individual needs, customer expectations, and worker availability. **Either worker classification—independent contractor or employee—can be a valid and appropriate business choice.**

Internal Revenue Service, U.S. Dep't of Treas., *Internal Revenue Service Training Materials on Worker Classifications for Tax Purposes as Independent Contractors or Employees* (Training 3320-102 rev. 10-96), TPDS

842381, issued March 4, 1997 ("Training Manual"), at p. i (emphasis in original).

It can be extremely difficult to determine whether a particular worker is an employee or independent contractor. In 1987, the IRS promulgated a list of twenty factors that affect the decision. Rev. Rul. 87-41, 1987-1 C.B. 296. These factors include whether the recipient of the services has the right to require compliance with instructions about when, where and how the work is performed; whether the recipient provides training; how "integrated" the worker's services are in the recipient's business operations; whether a continuing relationship is intended; whether full-time work is required; etc. Obviously, some factors may indicate an employer-employee relationship, while others may indicate an independent contractor relationship. Worse, there is no clear guidance on the relative weight to be accorded to each factor.

Changes over time compound the complexity of the determination. As a worker's duties and the employer's business change, the worker's employment status may change as well. The relevant test governing employment status also changes over time. As the IRS Training Manual points out:

> Bear in mind also that information important in helping determine worker status may change over time because business relationships change over time. As a result, some of the twenty common law factors listed in Rev. Rul. 87-41 are no longer as relevant as they once were.

Training Manual at 2-4.

Congress recognized the complexity of worker classification issues and specifically addressed taxpayer concerns about the potential for large, retroactive employment tax assessments in such cases. Section 530 of the Revenue Act of 1978, P.L. 95-600, 92 Stat. 2885, bars the IRS from reclassifying workers as long as the employer

had a reasonable basis for the classification, including reliance on long-standing industry practice or a past audit in which the IRS did not challenge the classification of similarly-situated workers. It also bars the IRS from issuing additional regulations or revenue rulings on worker classification issues. Although Section 530 was initially passed as a one year "stop-gap" measure, it was extended on an interim basis several times, and was extended indefinitely by Section 269 of the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248 ("TEFRA"), 96 Stat. 552. Congress also enacted a provision to mitigate retroactive employment tax liability where Section 530 relief is not available. 26 U.S.C.A. § 3509 (West Supp. 1997), as enacted by TERFA § 270.

The IRS has also attempted to respond to taxpayer concern about how the retroactive recharacterization of workers can affect businesses. In addition to implementing comprehensive training procedures for its agents (as evidenced by the Training Manual), the IRS recently promulgated a Classification Settlement Program ("CSP"), in order to address and relieve the possibility of draconian penalties from worker misclassification. 23 Pens. & Ben. Rep. (BNA) 1343 (May 20, 1996). Under the CSP:

> businesses that have misclassified their workers as independent contractors, have filed Form 1099 information returns, but have failed to meet the other requirements for relief under section 530 [of the Revenue Act of 1978], can settle the matter with IRS examiners by reclassifying their workers prospectively and paying only limited tax assessments. This eliminates the risk that tax assessments could be applied for multiple years.

Hearing on Small Business Taxation Proposals Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance, 105th Cong. (1997) (statement of

Donald C. Lubick, Acting Ass't Sec'y, U.S. Dep't of Treas.).

Nonetheless, the area remains an important concern to United States businesses. Senator Christopher S. Bond recently stated:

> As the chairman of the Small Business Committee, I have heard from countless small business owners who are caught in the environment of fear and confusion that now surrounds the classification of workers. This situation is stifling the entrepreneurial spirit of many small business owners who find that they do not have the flexibility to conduct their businesses in a manner that makes the best economic sense and that serves their personal and family goals.

143 Cong. Rec. S2429 (daily ed. Mar. 18, 1997).

There is no finding in this case that Microsoft acted in bad faith in characterizing the freelancers as independent contractors for tax purposes, or that the freelancers were somehow hoodwinked into agreeing to the characterization. Presumably, the parties agreed to the characterization because they legitimately, but mistakenly, believed it was accurate.

Nonetheless, when the IRS recharacterized the freelancers as employees rather than independent contractors, it triggered a specific set of statutory provisions imposing specific liability on Microsoft. The Ninth Circuit has gone far beyond the statutory liability associated with worker misclassification. At the same time that Congress and the IRS have made efforts to minimize the retroactive impact of worker misclassification, and to increase the predictability associated with worker classification issues,

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[4] According to a recent report, there are currently 1,500 cases in the CSP. 24 Pens. & Ben. Rep. (BNA) 1104 (May 5, 1997). This provides a sense of how significant this case is, in that each of these 1,500 employers—the tip of the iceberg—may be open to a claim under the Ninth Circuit's theory in *Vizcaino*.

the Ninth Circuit has unfairly imposed enormous retroactive liability on Microsoft and increased the risks associated with worker misclassification for all employers.

If it stands, the court's ruling will result in a flood of litigation, in which workers will challenge the independent contractor status that they themselves agreed to, in order to gain windfall benefits. The workers will have the advantage of litigating a complex, subjective and shifting test of employment status.

III. THE NINTH CIRCUIT MISCONSTRUED THE ESPP.

Companies use stock purchase plans, like Microsoft's ESPP, as a means of instilling loyalty among employees and aligning the employees' financial interests with the interests of the company's shareholders. Further, stock purchase plans provide regular employees, who forgo flexibility and often work for lower hourly compensation, with an opportunity to participate in their employers' long-term growth as a reward for staying with the company. Many of the publicly-traded members of the Employer Amici have employee stock purchase plans.

The Ninth Circuit fundamentally misunderstood the nature of stock purchase plans when it imputed to Microsoft the intent to cover the freelancers under the ESPP. It is extremely unusual for a company to provide equity-based compensation to alternative workers, because such workers have not made the same type of commitment to the company as its regular employees. Alternative workers are not expected to contribute to the long-term growth of the company, so it makes little sense to reward them with equity compensation that is normally realized over a number of years.

The ESPP is subject to Section 423 of the Code, 26 U.S.C.A. § 423, which provides certain tax benefits to stock purchase plans that meet its requirements. Under Section 423, a stock purchase plan must be available to

all employees with certain exceptions—and *only* to employees. Consistent with the notion that it makes little sense to provide equity-based compensation to temporary workers, employees who have worked for an employer under two years and part-timers may be excluded from participation.

It is clear from the ICAs that Microsoft did not intend to cover the freelancers in the ESPP. Had Microsoft wanted or intended to provide equity compensation to the freelancers, it could have done so perfectly "legally" using non-qualified stock options or restricted stock (or other "shadow stock" techniques), and only the tax result would have differed from that provided by the ESPP. But, in fact, neither Microsoft nor the freelancers intended this.

The ESPP is not subject to the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C.A. §§ 1001-1461 (1985) ("ERISA"), so no enforceable participation requirement can be found under Federal law. What the Ninth Circuit has done in this case is provide the freelancers a private right of action to enforce the requirement in Section 423 of the Code that an employee stock purchase plan must cover all employees in order to receive favorable tax treatment. The Code itself provides no such cause of action, and this Court has made it clear that none may be inferred. *Cort v. Ash*, 422 U.S. 66 (1975).

IV. THE NINTH CIRCUIT UTTERLY NEGATED WASHINGTON LAW.

The Ninth Circuit's decision completely disregards Washington contract law by casting aside the unambiguous agreements between Microsoft and the freelancers and binding the two parties to a new agreement to which they never assented. The Supreme Court of Washington has repeatedly held that its courts cannot ignore a contract's express language:

> In construing a contract, a court must interpret it according to the intent of the parties as manifested by the words used. Courts can neither disregard contract language which the parties have employed nor revise the contract under a theory of construing it. An interpretation of a writing which gives effect to all its provisions is favored over one which renders some of the language meaningless or ineffective.

Wagner v. Wagner, 621 P.2d 1279, 1283 (Wash. 1980); *Mayer v. Pierce County Med. Bureau, Inc.,* 909 P.2d 1323 (Wash. 1995); *Corbray v. Stevenson,* 656 P.2d 473, 475 (Wash. 1982) ("[C]ontracts should be construed to reflect the intent of the parties . . . and courts, under the guise of construction or interpretation, should not make another or different contract for the parties.").

The ICAs state not only that the freelancers were independent contractors, but *further* that they agree to be responsible for their own "insurance and other benefits." *Vizcaino v. Microsoft Corp.,* 120 F.3d at 1019. The Ninth Circuit's reading of the contract ignores the requirement of Washington law that a contract be interpreted so that all provisions are meaningful and effective and consistent with the intent of the parties. *Wagner,* 621 P.2d at 1283; *Tanner Elec. Coop. v. Puget Sound & Light Co.,* 911 P.2d 1301, 1310 (Wash. 1995) ("The touchstone of contract interpretation is the parties' intent."); *Seattle-First National Bank v. Earl,* 565 P.2d 1215, 1218 (Wash. 1977).

Similarly, the court ignores Washington law on contract reformation. In reforming a contract, a court may not impose new obligations on a party; instead, the court may reform the contract only to reflect the parties' actual intent in making agreement. *Seattle-First,* 565 P.2d at 1218 (Wash. 1977) ("It is a longstanding rule that courts cannot, and ought not, make a contract for parties which they did not make for themselves or impose upon one party an obligation which was not assumed."); *Weyer-*

haueser Timber Co. v. Skaglund, 132 P.2d 724, 725-726 (Wash. 1942). ("Courts of equity do not rectify contracts. They simply rectify instruments purporting to have been made in pursuance of the terms of the contract.").

Finally, the Ninth Circuit's decision disregards the settled legal principle that an individual "should not be permitted unjustly to enrich himself at the expense of another." *Bill v. Gattavara,* 209 P.2d 457, 459 (Wash. 1949); *Hatley v. West,* 445 P.2d 208, 210 (Wash. 1968). The *Vizcaino* opinion stands this equitable principle on its head, by creating a contract that without question unjustly enriches the freelancers, each of whom received exactly what they agreed and expected to be paid for their services.

In declining to enforce the ICAs, the Ninth Circuit reaches a result directly contrary to the opinion of the Court of Appeals for the Tenth Circuit in *Boren v. Southwestern Bell Telephone Co.,* 933 F.2d 891 (10th Cir. 1991). Mr. Boren sought benefits as an employee, after working for Southwestern Bell for over 20 years pursuant to a series of agreements labeling him an independent contractor. The Tenth Circuit held that ERISA did not apply, because Brown was not a "participant" for ERISA jurisdictional purposes. In reviewing Boren's contract claim, however, the court held that Boren's agreement not to be considered an employee "prevent[s] him from claiming that the work he performed for Southwestern Bill constituted an acceptance of the company's unilateral offer of pension benefits. Clearly, neither party intended Mr. Boren's work to constitute such an acceptance." 933 F.2d at 894. Because the service contracts fixed the rights as between the parties, and the rights of third parties were not at issue, the court did not believe it necessary to determine whether Boren was actually an "employee" under common-law standards. *Id.*

The Court of Appeals of Washington reached precisely the same result in *Daniel v. Pacific Northwest Bell Tele.*

Co., 580 P.2d 652 (Wash. App. 1978), *review denied*, 90 Wash.2d 1025 (Wash. 1978).

CONCLUSION

For the reasons set forth above, we respectfully urge this Court to grant Microsoft's Petition for Writ of Certiorari.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

MICROSOFT CORPORATION, *et al.*,

Petitioners,

—v.—

DONNA VIZCAINO, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MICROSOFT CORPORATION'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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January 5, 1998

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List of Parties and Rule 29.6 Statement

There have been no changes in the information previously submitted by petitioner Microsoft Corporation, pursuant to Rule 29.6, in its petition for writ of certiorari.

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MICROSOFT CORPORATION'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

The Ninth Circuit *en banc* majority failed to follow settled principles of state contract law and refused even to acknowledge an intermediate state appellate court decision that is directly on point—in violation of this Court's decisions in *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), *Fidelity Union Trust Co.* v. *Field*, 311 U.S. 169 (1940), and *West* v. *AT&T*, 311 U.S. 223 (1940). None of the arguments advanced by respondents in their brief in opposition make this case any less appropriate for summary review by this Court.

Like the Ninth Circuit *en banc* majority, respondents pay lip service to the notion that their claim for ESPP benefits is governed by state contract law, and then promptly proceed to ignore the terms of their actual contracts with petitioner Microsoft Corporation ("Microsoft"). Those contracts expressly provide that respondents are *not* entitled to ESPP benefits.

Rather than examine the terms of their contracts, respondents purport to construe the terms of the ESPP itself. Respondents argue that "[b]y its express terms, the ESPP is open to 'any employee' who meets certain service requirements," and they assert that Microsoft has "admitted that [respondents] are 'employees' within the meaning of the ESPP and that they had sufficient service." (Opp'n at 5.) Respondents further contend that "it is the facts concerning employment that determine employee status, not the words of the contract alone." (*Id.* at 20.)

In other words, respondents claim that they are entitled to participate in the ESPP because they are purportedly covered by the provisions of the plan, regardless of whether they can show that they have a valid contractual right to participate in the ESPP. As a result, respondents (like the Ninth Circuit *en banc* majority) improperly treat the ESPP as if it were an ERISA plan, ignoring settled principles of state contract law in the process.

Respondents' brief in opposition is replete with other misstatements that require a reply.

1. **Microsoft's petition presents a question of exceptional importance.** Respondents attempt to downplay the significance of this case, arguing that it involves only "a single contract of a particular employer." (Opp'n at 11.) Respondents state: "the Ninth Circuit's decision does not control even future cases in Washington State, let alone the remaining 49 states." (*Id.* at 26.) Yet five different national associations have submitted two *amicus curiae* briefs in support of Microsoft's petition stressing the importance of this case to their members. Those associations would not have gone to that effort if, as respondents contend, this case involves only "a single contract of a particular employer." (*Id.* at 11.)

Attesting to the importance of the question presented by Microsoft's petition, the Chamber of Commerce of the United States (the world's largest business federation representing more

than three million businesses and organizations) and the Association of Private Pension and Welfare Plans (a trade association with more than 240 members, including many Fortune 500 companies) state as follows in their motion for leave to file their *amicus curiae* brief:

> The issue raised by the Petition—whether individuals who execute written freelance agreements specifically acknowledging that they are not entitled to employee benefits subsequently may sue for such benefits by claiming that they are common law employees—is of direct and immediate interest to the Amici and their members. Amici and their members wish to preserve their right to contract with freelancers on mutually advantageous terms, which may include agreements concerning the availability of benefits. The decision below threatens this freedom, and thereby jeopardizes the stability of this large segment of the American workforce.

Similarly, the Information Technology Association of America, the American Electronics Association and the Software Publishers Association—three leading trade associations in high technology industries—state in their *amicus curiae* brief that "[t]his case is of exceptional importance to the industries represented by [them]." According to these *amici*, the Ninth Circuit *en banc* majority's decision in this case "upsets the legitimate, settled contractual rights of businesses throughout all industries." The *amici* state, however, that the "information technology" and electronics industries "are particularly at risk from the fallout of *Vizcaino*" because of (i) "their extensive use of highly skilled alternative workers, such as computer programmers, product testers and systems analysts," and (ii) their "common use of equity compensation to reward employees."

2. The Ninth Circuit was not at liberty to ignore the Washington Court of Appeals' decision in *Daniel* v. *Pacific Northwest Bell Telephone Co.*, 580 P.2d 652 (Wash. Ct. App. 1978). Relying on this Court's decision in *King* v. *Order of*

United Travelers of America, 333 U.S. 153 (1948), respondents suggest that the Ninth Circuit was not bound by *Daniel* because the intermediate appellate court that rendered that decision has "jurisdiction over only Eastern Washington" (Opp'n at 14), and because "the Washington Supreme Court reverses over half of the decisions of the Washington court of appeals accepted for discretionary review"(*id.* at 15). Respondents' reliance on *King* is misplaced.

In *King*, this Court reiterated the bright-line rule that "federal courts are bound by decisions of a state's intermediate appellate courts unless there is persuasive evidence that the highest state court would rule otherwise." 333 U.S. at 158 (citing *Six Companies of Cal.* v. *Joint Highway Dist. No. 13 of Cal.*, 311 U.S. 180 (1940); *West* v. *AT&T*, 311 U.S. 223 (1940); *Stoner* v. *New York Life Ins. Co.*, 311 U.S. 464 (1940)). The Court next noted that in *Fidelity Union Trust Co.* v. *Field*, 311 U.S. 169 (1940), the Court "went further and held that a federal court had to follow two decisions announced four years earlier by the New Jersey Court of Chancery, a court of original jurisdiction." 333 U.S. at 158. The Court explained that although the *Fidelity Union* case did not "lay down any general rule as to the respect to be accorded state trial court decisions," it "took pains to point out that the status of the New Jersey Court of Chancery" was not that of the usual trial court. *Id.* at 159. In particular, this Court noted, among other things, that the New Jersey Court of Chancery has "state-wide jurisdiction" and that "[a] uniform ruling by the Court of Chancery over a course of years was seldom set aside by the state's highest court." *Id.*

Contrary to respondents' suggestion, the Court did not hold in *King* that federal courts are free to ignore a decision of an intermediate state appellate court if that state court lacks state-wide jurisdiction or is sometimes reversed by the state's highest court. Instead, the Court explicitly stated that "federal courts are bound by decisions of a state's intermediate appellate courts unless there is persuasive evidence that the highest state court

would rule otherwise." *Id.* at 158. Considerations such as whether the state court has state-wide jurisdiction or is reversed with some frequency are relevant only in determining "the respect to be accorded *state trial court decisions*." *Id.* at 159 (emphasis added). There is no dispute that the Washington court that decided *Daniel* is an intermediate appellate court, not a trial court, and thus the "federal courts are bound" by *Daniel* "unless there is persuasive evidence that the highest state court would rule otherwise." *Id.* at 158. No such evidence exists in this case.

3. Just because the Ninth Circuit cited certain Washington Supreme Court decisions does not mean that it correctly applied Washington law. Respondents note that the Ninth Circuit *en banc* majority cited "several Washington Supreme Court cases," as if that fact alone were sufficient to immunize the Ninth Circuit's decision from review. (Opp'n at 9; *accord id.* at 24.) As Microsoft explained in its petition, none of the Washington Supreme Court decisions cited by the Ninth Circuit *en banc* majority is on point. (*See* Pet. at 16 n.6.) In fact, respondents themselves have acknowledged in prior court papers that "there is *no* decision on point from the Washington Supreme Court" (emphasis added). As this Court held in *West*, a federal court is not free to reject, as the Ninth Circuit *en banc* majority did in this case, a decision of an intermediate state appellate court that is directly on point in favor of a decision or decisions of the highest state court that only tangentially relate to the question presented. *See* 311 U.S. at 235.

By the same token, respondents' criticism of the district court for relying "*only* on federal cases" and "not citing or discussing a single Washington decision" (Opp'n at 6 (emphasis in original); *accord, e.g., id.* at 2, 24) is disingenuous. In granting Microsoft summary judgment on respondents' claim for ESPP benefits, the district court adopted by reference the magistrate judge's general analysis of state contract law (A74-75) and cited federal case law only for the proposition that Section 423 of the

Internal Revenue Code "does not create a right of action by [respondents] against Microsoft" (A76).

4. The *Daniel* decision is still good law and thus is binding on the federal courts. Respondents devote much of their brief to arguing that *Daniel* was wrong "when it was originally decided" and has since been "effectively overruled." (*See* Opp'n at 15-17, 18-23.) Respondents' arguments are baseless.

As an initial matter, the Ninth Circuit *en banc* majority did not predicate its refusal to follow *Daniel* on any of the reasons offered by respondents, even though respondents presented those very same arguments to the Ninth Circuit in their response to Microsoft's petition for rehearing. Rather, the Ninth Circuit simply ignored *Daniel*, notwithstanding Judge O'Scannlain's explicit statement in his dissent that *Daniel* "rejected the court's reasoning." 120 F.3d at 1020 (A31). The Ninth Circuit *en banc* majority's decision to ignore *Daniel* speaks volumes about the weakness of respondents' arguments that *Daniel* is no longer good law.

What respondents really want this Court to do is what the Ninth Circuit *en banc* majority did: reject *Daniel* in favor of decisions of the Washington Supreme Court that only tangentially relate to the question presented. This Court should reject that invitation. The Washington Court of Appeals' decision in *Daniel* has "remained on the books" for nearly twenty years "without disapproval" from any court. *King*, 333 U.S. at 158 n.13; *accord Six Companies*, 311 U.S. at 188. The Washington Supreme Court may at some later time endorse, adopt, modify or reject the rule of *Daniel*, but it has not done so yet. Nor has any lower Washington court taken the position that *Daniel* is no longer good law or was wrongly decided. Whether the Washington Supreme Court will some day modify or reject the rule of *Daniel* thus "remains a matter of conjecture." *West*, 311 U.S. at 238. Consequently, the federal courts continue to be bound by *Daniel*.

Respondents incorrectly contend (Opp'n at 16-17) that the Washington Supreme Court "effectively overruled" *Daniel* in *Berg* v. *Hudesman*, 801 P.2d 222 (Wash. 1990). That contention reflects both a substantial over-reading of *Berg* and a misunderstanding of *Daniel*. In fact, *Daniel* is entirely consistent with *Berg*. In *Berg*, the Washington Supreme Court held only that "extrinsic evidence is admissible as to the entire circumstances under which a contract was made, as an aid in ascertaining the parties' intent." 801 P.2d at 229. The Washington Court of Appeals' did *not* hold in *Daniel* that extrinsic evidence was inadmissible to ascertain the parties' intent. To the contrary, the Washington Court of Appeals expressly considered extrinsic evidence in *Daniel*, noting that such evidence established that plaintiff "knew" that his agreements with defendant did not provide for employee benefits. *See* 580 P.2d at 653 ("Mr. Daniel knew that these items were not provided by the agreement because as late as March 23, 1973, he wrote the telephone company seeking some arrangement for these items."). Similarly, respondents' contention that *Daniel* "was inconsistent with Washington law even when it was originally decided" (Opp'n at 18-23) overlooks the fact that the Washington Supreme Court denied review in *Daniel*. *See* 90 Wash. 2d 1025 (Wash. 1978).

All that the Washington Court of Appeals held in *Daniel* was that plaintiff was bound by the contract that he voluntarily and knowingly signed—which provided that he was an independent contractor not entitled to employee benefits—and thus was precluded "from showing that in actuality he was an employee, and not an independent contractor." 580 P.2d at 653-54. That unremarkable holding, which is completely consistent with *Berg*, is still good law.

Finally, it is ironic that respondents would argue that *Daniel* has been effectively overruled because it purportedly precludes consideration of extrinsic evidence. The extrinsic evidence of the parties' intent in this case uniformly supports Microsoft's position. Consistent with respondents' agreements with Microsoft,

the extrinsic evidence confirms that respondents had no expectation of receiving the benefit they now seek and that Microsoft had no expectation of providing such a benefit. The magistrate judge explained:

> As with the other employee benefits governed by state law, it is uncontested that Plaintiffs signed the above-described [Independent Contractor Agreement] and companion papers acknowledging that they were responsible for their "own benefits." As with the other benefits governed by state law, no Plaintiff claims that he/she was ever told by anyone at Microsoft that he/she had a right to participate in the ESPP, and to the extent that any of them knew about the plan or saw company materials concerning the plan, they did not consider themselves eligible to participate in the ESPP because of their status as freelancers. The uncontested evidence is thus that Microsoft never expressly offered the ESPP benefit to Plaintiffs, and no Plaintiff had any expectation of receiving it as a portion of his/her compensation for any services performed by any Plaintiff as a freelancer on behalf of Microsoft. Rather, all Plaintiffs understood that they would *not* receive the benefit.

(A103.) Such extrinsic evidence of the parties' intent is obviously supports Microsoft's position that respondents are not entitled to ESPP benefits.

5. Respondents fail to offer a good reason why, at a minimum, the dispositive state-law question should not be certified to the Washington Supreme Court. Even though they themselves sought certification in the court of appeals, respondents argue that this Court should reject Microsoft's "remarkable proposal" that the Court grant certiorari, vacate the judgment of the court of appeals and remand with instructions to certify the dispositive state-law question. (Opp'n at 24.) Contrary to respondents' assertion (*id.* at 25), this Court has never held that certification is appropriate only to resolve the construction of a state statute subject to a federal constitutional

challenge. In *Lehman Brothers* v. *Schein*, 416 U.S. 386, 391 (1974), this Court emphasized that certification "helps build cooperative judicial federalism." Certifying the dispositive state-law question in this case—which has divided numerous federal jurists as well as *amicus curiae* supporting both parties—to the Washington Supreme Court would be consistent with such co-operative judicial federalism.

Lastly, although respondents criticize Microsoft's formulation of the state-law question as "incomplete and biased" (Opp'n at 24), they fail to offer a formulation of their own. Their failure to do so undermines their criticism.

Conclusion

This Court should grant certiorari and summarily reverse the judgment of the court of appeals for refusing to apply the rule of law announced by the Washington Court of Appeals in *Daniel* v. *Pacific Northwest Telephone Co.*, 580 P.2d 652 (Wash. Ct. App.), *review denied*, 90 Wash. 2d 1025 (Wash. 1978). In the alternative, the Court should grant certiorari, vacate the judgment of the court of appeals and remand the case with

instructions to certify the dispositive question of Washington law to the Washington Supreme Court.

Respectfully submitted,

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January 5, 1998

ORIGINAL

Supreme Court, U.S.
FILED
JAN 5 1998
CLERK

No. 97-0854

In The
Supreme Court of the United States
October Term, 1997

MICROSOFT CORPORATION, *et al.*,

Petitioners,

—v.—

DONNA VIZCAINO, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENTS' OPPOSITION TO MOTIONS FOR LEAVE TO SUBMIT AMICI BRIEFS BY CHAMBER OF COMMERCE, *et al.*, and INFORMATION TECHNOLOGY ASSOCIATION, *et al.*

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INTRODUCTION

Respondents oppose motions by employer groups to submit two *amici* briefs. The motions, dated Wednesday, December 24, 1997, were not received by Respondents' counsel until Friday, January 2, 1998. The motions are by the Chamber of Commerce of the U.S., *et al.* (hereafter "Chamber Br."), and the Information Technology Association, *et al.* (hereafter "ITA Br.").

ARGUMENT

The proposed *amici* briefs state they are in support of Microsoft's petition, which, in turn, seeks summary action. Proposed *amici* are employers' groups related to Microsoft (*e.g.*, Software Publishers Ass'n) and supporting Microsoft with *amici* briefs below. The groups did not file and serve Respondents' counsel with the proposed *amici* briefs until after Respondents' Brief was already submitted, leaving no opportunity for Respondents to deal with their arguments. In effect, this could give Microsoft an additional 30 pages of reply briefs. Indeed, Microsoft quotes and incorporates the proposed *amici* briefs in its Reply.

If Microsoft were seeking full review, with briefing on the merits after granting a writ of certiorari, Respondents would simply deal with these points in their brief on the merits. Microsoft, however, does not request full review and briefing. Pet., pp. 21, 22. The *amici* briefs should be rejected because they were not submitted early enough to permit Respondents to address their arguments in their brief in opposition.

The proposed briefs also shed no light whatsoever on the issues of Washington law here. The Chamber brief cites not even a single Washington case. The briefs instead propose, even though this case is governed by Washington law, that this Court should adopt, contrary to *Erie,* a rule of federal common law -- *i.e.,* that employers' forms mislabeling employees as "contractors" always control over the facts. This proposed rule is not only contrary to the common law of Washington, it is also contrary to the general common law of agency (see *Restatement (2d) of Agency §220(2)*) applied throughout the United States. See *Nationwide Mutual Ins. v. Darden,* 503 U.S. 318, 322-24 (1992)(adopting general common law for purposes of defining "employee" under ERISA).

Interestingly, the Paul, Hastings law firm, submitting the proposed *amici* brief for the Chamber, *et al.* (and which also submitted two *amici* briefs in the Ninth Circuit for several employer groups), has a very different public analysis of the Ninth Circuit's *Vizcaino* decision from that which it argues here. In the Paul, Hastings public Website,[1] the firm states:

> On July 24, 1997, the Ninth Circuit issued its long-awaited, en banc decision in *Vizcaino v. Microsoft Corporation,* holding that certain employee benefits might have to be provided to individuals whom Microsoft had misclassified as independent contractors. The majority's logic was quite simple:
>
> - The benefit plans covered common law employees.
> - The plaintiffs *were* common law employees.
> - Hence, the plaintiffs were eligible or potentially eligible for plan benefits.
>
> * * *
>
> Although the holding in *Microsoft* is fact-specific (and, therefore, possibly of limited precedential value), the message of the case is unmistakably clear, at least to employers in the Ninth Circuit: *Do not expect a benefit exclusion premised on employment status misclassification to be upheld.* (Emphasis original.)

Accordingly, the Paul, Hastings firm recommended that employers

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[1] www.phjw.com/ca2.htm (1/5/98).

"take appropriate steps to minimize worker misclassification, which is endemic." *Id.*

Similarly, the Seyfarth, Shaw law firm, submitting the proposed ITA, *et al., amici* brief, summarized pertinent portions of the Ninth Circuit's *Vizcaino* decision on its public Website[2]:

> The ESPP was intended to comply with Section 423 of the Internal Revenue Code and, as a result, covered all employees of Microsoft.
>
> * * *
>
> ...[T]he court found that Microsoft intended the ESPP to comply with Section 423 of the Internal Revenue Code, which requires that all common law employees be covered by each offering under a plan. Because the plaintiffs met the common law employee test, regardless of their independent contractor designation, they were eligible to purchase stock under the ESPP.
>
> ... In addition, the court found that by incorporating the requirements of Code Section 423 into the ESPP, Microsoft had extended an offer or constructive offer to the plaintiffs that was a sufficient basis for a contractual right to purchase stock under that arrangement.

CONCLUSION

If the Court were to review the merits of the Washington common law issues as Microsoft requests, there are many

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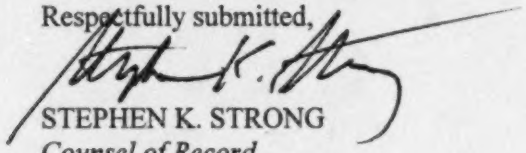
[2] www.seyfarth.com/insights/ MICROSOF.HTM (1/5/98)

arguments in *amici's* briefs that should be disregarded because they are based on false factual assertions concerning the nature of the employees in the class.

The proposed briefs should be rejected.

DATED: January 5, 1998.

Respectfully submitted,



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